Supreme Court, U.S.
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Case No. _____

IN THE
UNITED STATES SUPREME COURT

October Term, 1994

Charles A. Roth,

Petitioner,

v.

Securities and Exchange Commission,

Respondent.

Petition For Writ Of Certiorari To The United States Court Of Appeals For The District Of Columbia Circuit

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PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED FOR REVIEW

1. Whether the Court of Appeals Applied the Incorrect Standard for Interpreting Ambiguous Statutes That Are Penal In Nature When It Construed Section 15(a)(1) of the Securities Exchange Act of 1934.

2. Whether the Court of Appeals' Interpretation of Section 15(a)(1) of the Securities Exchange Act of 1934 Can Be Constitutionally Applied to Roth Under the Facts of This Case.

3. Whether the Court of Appeals Erred by Upholding Sanctions Imposed by the Securities and Exchange Commission in the Absence of an Articulation of Reasons by the Commission Justifying the Seriousness of the Sanctions.

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REFERENCE TO REPORTS OF OPINIONS DELIVERED IN THE CASE BY OTHER COURTS OR ADMINISTRATIVE AGENCIES

1. Roth v. Securities and Exchange Commission, 22 F.3d 1108, 62 USLW 2624, Fed. Sec. L. Rep. (CCH) ¶ 98,206 (D.C. Cir. 1994).

2. In Re Charles A. Roth, 52 SEC Docket 1102, Exchange Act Rel. No. 34-31085, 1992 WL 2166933 (S.E.C. 1992).

STATEMENT OF GROUNDS ON WHICH JURISDICTION OF THIS COURT IS INVOKED

A. Date of Entry of the Judgment or Decree Sought to be Reviewed.

The Order and Judgment sought to be reviewed is the March 16, 1994 Order of the Court of Appeals.

B. Date of Any Order Respecting a Rehearing.

Petitioner Roth filed a timely Petition For Rehearing before the Court of Appeals on May 5, 1994. Petitioner Roth's Petition For Rehearing was denied by the Court of Appeals on June 2, 1994.

C. Statutory Provision Conferring on this Court Jurisdiction to Review the Judgment or Decree in Question by Writ of Certiorari.

This Court has jurisdiction to review the judgment or decree in question pursuant to 28 U.S.C. § 1254.

VERBATIM STATEMENT OF CONSTITUTIONAL PROVISIONS, STATUTES, AND REGULATIONS INVOLVED IN THE CASE

A. Constitutional Provisions.

U.S. Const. amend. V

> No person shall be held to answer for a capital, or otherwise infamous crime, unless on a presentment or indictment of a Grand Jury, except in cases arising in the land or naval forces, or in the Militia, when in actual service in time of War or public danger; nor shall any person be subject for the same offence to be twice put in jeopardy of life or limb; nor shall be compelled in any criminal case to be a witness against himself, nor be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation.

B. Statutes.

(i) Section 3(a)(4) of the Securities Exchange Act, 15 U.S.C. § 78c(a)(4):

> The term "broker" means any person engaged in the business of effecting transactions in securities for the account of others * * *.

(ii) Section 15(a)(1) of the Securities Exchange Act, 15 U.S.C. § 78o(a)(1):

> It shall be unlawful for any broker or dealer which is * * * a natural person not associated with a

broker or dealer * * * [to make use of interstate commerce] to effect any transactions in, or to induce or attempt to induce the purchase or sale of, any [non-exempt] security * * * unless such broker or dealer is registered * * *.

C. **NASD Requirements**.

(i) Article III, Section 1, of the NASD's Rules of Fair Practice, NASD Manual (CCH) ¶ 2151 (1993 reprint):

> A member, in the conduct of his business, shall observe high standards of commercial honor and just and equitable principles of trade.

(ii) Notice Requirement effective until November 12, 1985:

Board of Governors' Interpretation, Article III, Sections 1, 27, and 28, NASD Manual (CCH) ¶ 2177, at 2109-3 (May 1985 reprint).

The interpretation provided:

> It shall be deemed conduct inconsistent with just and equitable principles of trade for any person associated with a member to engage in a private securities transaction outside the regular course or scope of his association or employment with a member, for himself, or with or for any other person without prior

written notification to the member. * * *.

(iii) Notice Requirement effective November 12, 1985 and thereafter:

Article III, Section 40 of the NASD's Rules of Fair Practice, NASD Manual (CCH) ¶ 2200 at 2186-2188 (September 1988 reprint) provides in relevant part:

> (a) Applicability -- No person associated with a member shall participate in any manner in a private securities transaction except in accordance with the requirements of this section.
>
> (b) Written Notice -- Prior to participating in any private securities transaction, an associated person shall provide written notice to the member with which he is associated describing in detail the proposed transaction and the person's proposed role therein and stating whether he has received or may receive selling compensation in connection with the transaction; * * *.

(c) Transactions for Compensation --

(1) In the case of a transaction in which an associated person has received or may receive selling compensation, a member which has received notice * * * shall advise the associated person in writing stating whether the member: (A) approves the person's participation in the proposed transaction; or (B) disapproves the person's participation in the proposed transaction.

(2) If the member approves a person's participation in a transaction pursuant to Subsection (c)(1), the transaction shall be recorded on the books and records of the member and the member shall supervise the person's participation in the transaction as if the transaction were executed on behalf of the member.

(3) If the member disapproves a person's participation pursuant to Subsection (c)(1), the person shall not participate in the transaction in any manner, directly or indirectly.

* * * *

(e) Definitions -- For purposes of this section, the following terms shall have the stated meanings:

(1) "Private securities transaction: shall mean any securities transaction outside the regular course or scope of an

associated person's employment with a member * * *.

(2) "Selling compensation" shall mean any compensation paid directly or indirectly from whatever source in connection with or as a result of the purchase or sale of a security, including, though not limited to, commissions; finder's fees; securities or rights to acquire securities; * * * or expense reimbursements.

(iv) Article V, Section 1 of the NASD's Rules of Fair Practice, NASD Manual (CCH) ¶ 2301 at 2215 (March 1988 reprint) (in effect at the time Roth was charged):

> [The NASD may] impose a fine not in excess of Fifteen Thousand Dollars ($15,000.00) upon any member or person associated with a member * * * for each or any violation of any of these Rules by a member or person associated with a member * * *.

STATEMENT OF THE CASE

A. Basis For Federal Jurisdiction in the Court of First Instance.

Petitioner Roth sought review by the Court of Appeals of a final disciplinary decision entered by the Securities and Exchange Commission. Accordingly, the basis for jurisdiction in the court of first instance,

the Court of Appeals for the District of Columbia Circuit, was Section 25 of the Securities and Exchange Act of 1934, 15 U.S.C. § 78y (1981 and 1993 Cum. Supp.) and F.R.A.P. 15(a).

B. Subject Matter Jurisdiction in the Agency

The Securities and Exchange Commission ("Commission") had subject matter jurisdiction pursuant to Sections 19(d) and (e) of the Securities Exchange Act of 1934 ("Exchange Act"), 15 U.S.C. §§ 78s(d) and (e) (1981), and Commission Rule 19d-3 promulgated thereunder. Petitioner Roth sought review by the Commission of the final disciplinary action of the National Association of Securities Dealers, Inc. ("NASD") against Roth entered February 13, 1990. Roth is, and was, a person associated with a member of the NASD.

C. Facts Material to the Consideration of the Questions Presented

On February 13, 1990, the Board of Governors of the NASD issued its Decision in

Complaint No. DEN-815, District No. 3, In the Matter of District Business Conduct Committee for District No. 3 v. Charles A. Roth. Said Decision concluded:

(1) that Petitioner Roth failed to register as a securities broker with the Commission or the NASD pursuant to § 15 of the Securities Exchange Act of 1934;

(2) that Roth violated Article III, Section 1 ("Section 1") of the NASD Rules of Fair Practice by effecting prior to November 12, 1985 "private securities transactions" for the accounts of others without obtaining written permission to do so from the NASD Member Firm with which he was associated; and

(3) that Roth violated Article III, Section 40(b) ("Section 40") of the NASD Rules of Fair Practice concerning alleged "private securities transactions" effected on or after November 12, 1985.

The Decision of the NASD Board of Governors resulted from the review by the NASD National Business Conduct Committee ("NBCC") of a prior decision of the District Business Conduct Committee for District No. 3 ("DBCC"). This prior decision of the DBCC, dated May 11, 1989, will be referred to herein as the "DBCC

Decision." The review of the DBCC Decision was made solely upon the motion of the Board of Governors of the NASD; Roth did not choose to appeal the DBCC Decision, although he disagreed with its conclusions.

On January 24, 1989, prior to the hearing before the DBCC, the NASD notified Roth in writing that the maximum fine which could be assessed against him if found guilty on all charges was $120,000. The document containing this notice, the NASD Answer Form, which was provided to Roth by the NASD, was executed by Roth when he filed his Answer to the charges in this proceeding, and returned by him to the NASD as the NASD had instructed.

Roth was not represented by counsel at this hearing because, based upon the Answer Form[1] and his discussions with the NASD, he

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[1] Paragraph 2 of the Answer Form (Report of Filing of Answer of Roth) specifies that, pursuant to Article V, Section 1 of the NASD Rules of Fair Practice, "a fine not in excess of $15,000 for each violation of the rules," could be imposed. Actually, a fine of $15,000 on a per-person basis was the maximum fine allowable; the NASD incorrectly interpreted

believed the cost of such legal counsel would exceed the largest probable sanction.

Roth was correct, the sanction initially imposed against him in the DBCC Decision was:

(1) Public censure;

(2) A fine of $20,000; and

(3) Suspension from associating with any member of the NASD for twenty (20) days.

Even though Roth disagreed with the DBCC Decision and was disappointed by the blemish it placed on his otherwise exemplary record during thirty-seven (37) years of practice as a registered securities representative, Roth was willing to live with the DBCC Decision. However, shortly thereafter, the NBCC served notice on Roth that it intended, on its own motion, to review the DBCC Decision.

Expecting that he could only improve - and not worsen - his lot, Roth again elected not to

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Article V when it stated that a fine of $15,000 could be imposed for <u>each violation</u>.

bear the cost of hiring legal counsel to represent him at the second hearing; doing so simply appeared uneconomical under the circumstances. However, the NBCC grossly abused its discretion in its Decision upon the second hearing, dealing a devastating, unjustified, and illegal blow to Roth's reputation and his ability to earn a living and provide for his dependents. While the NBCC purported to affirm the DBCC Decision, in reality the NBCC overruled the DBCC, imposing sanctions that were increased so vastly over those imposed by the DBCC that they can only be described as draconian.

The Decision of the NBCC[2] imposed a harsh and arbitrary punishment upon Roth. The Decision increased the fine imposed by the DBCC by a factor of twenty-five *(from $20,000 to*

[2] Pursuant to the NASD Code of Procedure, the Board of Governors delegated its review authority to the NBCC, which in turn delegated review authority to a Subcommittee of just two persons. This diminution of the number of persons conducting the second hearing may have contributed to the excessiveness of the Decision.

$510,038.13), and increased the suspension by a factor of nine *(from 20 days to 6 months)*; although the Decision purported to be based upon exactly the same conduct considered by the DBCC when it rendered its Decision. In addition, the Decision imposed the demeaning requirement that Roth requalify by examination, despite his exemplary career in the securities industry.

Roth's Exemplary History

Although the NASD had little interest in inquiring into the area, Petitioner Roth was anxious to point out in his *pro se* submissions and testimony to the NASD, that in his thirty-seven years (37) of practice, he had only one true customer complaint. He had previously been named in a lawsuit by a customer over a clearing dispute in which Roth had no fault. In fact, he had planned to testify on behalf of the customer at the trial, and was later dismissed from the suit. In another instance, Roth was fined by the Iowa Division of Securities for an inadvertent violation of its

rules for which, again, Roth had no responsibility.

In summary, Petitioner Roth has compiled an exemplary disciplinary record in his thirty-seven (37) years of practice. The securities industry needs more registered representatives cut from such fabric, not fewer.

The Nature of Roth's Business

The type of business conducted by Petitioner Roth is unusual; it is not easily described, or defined. It is not the kind of business done by the typical registered representative.

The bulk of Roth's practice consists of work he performs for large insurance companies. Depending upon the circumstances of the particular transaction, this work can be described as "consulting," "finding," "facilitating," "acting as a reinsurance intermediary," or "acting as a business broker." The Commission failed to recognize the subtle differences between the various

transactions which are the subject of this proceeding, and furthermore, failed to recognize the distinction between each of these transactions and a "private securities transaction" within the meaning of the NASD's Rules.[3] Instead, the Commission focused solely on its perception that somewhere, somehow, no matter how far removed from Roth, securities were transferred, or were planned to be transferred, in each of the transactions. This myopic view of the transactions ignored the "economic realities"[4] of the situation which must be examined in order to determine whether the transactions should be deemed to fall within the purview of Section 40.

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[3] Roth requested leave to supplement the record, with assistance of counsel, pursuant to Rule 19d-3(e) to enable the Commission to fully understand the transactions. The record is deficient in the kind of details pertaining to the six transactions which must be carefully examined in order to afford Roth a full and fair hearing. The Commission denied Roth that opportunity.

[4] See Tcherepnin v. Knight, 389 U.S. 332, 336 (1967).

In some of the transactions in which Roth was involved, one insurance company was interested in acquiring either 100% or controlling interest in another insurance company. Often, the simplest means of effecting such a sale of the business is to do so through the sale of the company's stock. If the circumstances of the particular case required the transfer of shares in the open market, Roth would utilize his relationship with Marich to accomplish such transfers. Roth frequently referred to this as Marich "clearing" the transfers. Roth also referred to himself at times as being a "market-maker" in a stock. Actually, it was Marich who made a market in stocks on his behalf.

When a particular transaction involved Roth's services in the capacity of a consultant, finder, facilitator, reinsurance intermediary, or <u>business</u> broker; Roth did not believe he was subject to the "private securities transaction" rule, and made no

special efforts to inform Marich of his activities (although Marich was in fact aware of many of them because it was involved in the "clearing" or "market making" aspects of these transactions.)

Thus, Roth's business was rather unique, or in Roth's words, "parochial." It was only tangentially related to the securities industry but, in order to run efficiently, required Roth to be a registered representative associated with a registered broker-dealer such as Marich.

The tangential involvement of Roth's business with the securities industry warranted only minimal supervision from the securities firm with which he was registered. When there were trades to be "cleared" or markets to be made, Marich was involved and supervised Roth's activities. In practice, because of Roth's long experience in the securities industry, his exemplary disciplinary record, and the high sophistication of his insurance company

clients, the supervision Marich needed to exercise was minimal.[5]

THE SIX TRANSACTIONS CURRENTLY AT ISSUE

	Insurance Co.	Date	Fees and Reimbursements Received by Roth
1.	Classified Financial Corp.	8/07/85	$ 5,180.50
2.	Amer. Nat'l Corp.	8/12/85	$ 87,078.68
3.	Yorktown Ins. Co.	12/23/85	$ 73,862.34
4.	Life Investors, Inc./Internat'l. Bank	12/12/85	$ 66,000.00
5.	Loyal American/ Purple Cross	6/86	$100,000.00
6.	United Ins. Co.,	7/86	$104,250.00
	Total		$436,371.52

[5] Although the transactions complained of in this case involved absolutely no harm being suffered by Roth's clients, the NBCC apparently felt that Roth was inadequately supervised by Marich. Incredibly, the NBCC blamed Roth, not Marich, for the lack of supervision. It is a logical absurdity to suggest that Roth was responsible for supervising Marich to ensure that Marich properly supervised him.

1. **Classified Financial Corp.; 8/7/85; $5,180.50**

In this transaction, Roth acted as, for lack of a better word, a facilitator. Mr. Philo Smith, of Philo Smith & Co., had previously made a $30,000,000 investment in Classified Financial Corp. There were a few thousand shares of the company's stock which Mr. Smith did not own. He wanted to acquire the rest, and enlisted the services of Roth to locate the other shareholders and encourage them to sell their shares to Smith. Roth had nothing to do with Smith's original acquisition of shares. Smith agreed to pay Roth's expenses in his investigation and evaluation of the proposed transaction. Roth successfully persuaded the owner of the outstanding stock, Victoria Financial Corporation, to sell its 79,700 shares of Classified Financial Corporation to Smith.[6] Roth received payment

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[6] The actual purchase was made by Investors Bank & Trust.

of $5,180.50 from Victoria Financial Corp. as compensation for his services.

2. **North American Nat'l Corp.; 8/12/85; $87,078.68**

In this transaction, Roth acted as a registered representative in assembling a block of stock in North American Nat'l Corp. on behalf of Southmark Corporation. Later, Southmark Corporation sold this block directly to the Loyal American Life Ins. Company. The firm Roth was associated with did not "clear" the transaction. Roth was not involved in the sale of the stock from Southmark to Loyal American. However, when the stock was sold by Southmark to Loyal American, Southmark paid Roth $12,078.68 as reimbursement for some of his expenses and Loyal American sent Roth $75,000 as "an accommodation", in recognition of assistance in facilitating the transaction.

3. **Yorktown Ins. Co.; 12/23/85; $73,862.34**

In this transaction, Roth acted as a "reinsurance intermediary" or a "business broker". Mr. Walter C. Walden, a long-time

personal friend of Roth owned 100% of the stock of Yorktown Ins. Company. A reinsurance intermediary from Florida, with whom Roth was acquainted, negotiated the sale of Yorktown to a group in New York City. The New York group needed to purchase the charter of a property and casualty insurance company for business which they controlled in an "all-lines" insurance agency. Thus, this was a clear reinsurance transaction. After approval of the transaction by the Illinois Insurance Department, the New York group purchased Yorktown's insurance charter. The Florida reinsurance broker shared the reinsurance brokerage fee with Roth.

4. **Life Investors, Inc./International Bank; 12/12/85; $66,000.00**

The most important aspect of this transaction was that it was never consummated.[7] The money received by Roth was merely a partial

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[7] Thus, by definition, Roth did not "effect private securities transactions for the accounts of others".

reimbursement for his expenses in the matter. In this transaction, Roth was supposed to have acted as a "business broker" on behalf of Southmark Corp. Southmark was interested in acquiring International Bank. Life Investors, Inc. owned 30% to 40% of the stock of International Bank. On behalf of Southmark, Roth secured an option to purchase Life Investors' stock in International Bank for $12 per share subject to approval of the insurance departments of the various states involved. However, prior to the completion of the approval process, one of the subsidiaries of International Bank bought this same block of stock for approximately the same price Southmark had intended to pay. Roth demanded that he be compensated by Life Investors for his efforts as a business broker because his efforts with respect to Southmark were what triggered the competing acquisition by International Bank's subsidiary. Life Investors refused to compensate Roth for his

efforts as a business broker but, perhaps fearing legal action, nevertheless paid him $66,000 in reimbursement for his expenses.

5. **Loyal American/Purple Cross Ins. Co.; 6/86; $100,000.00**

In this transaction, although there was eventually a sale of the entire business of Purple Cross, Roth was not involved in the securities aspects of this transaction. Rather, Roth was initially involved as a "finder" conducting an investigation into the financial circumstances of Purple Cross Ins. Company. Later, Purple Cross' financial difficulties involved Roth attempting to solve some of its reinsurance problems; and at that point, Roth may be fairly characterized as acting as a "reinsurance intermediary". But at no time did Roth act as a "broker" within the meaning of Section 15(a) of the Exchange Act, nor did he effect "private securities transactions" within the meaning of Section 40.

In this transaction, a Canadian company, Laurentian Capital Group, was interested in

acquiring the Purple Cross Ins. Co. of Seattle, Washington. Roth investigated Purple Cross and learned that certain inside shareholders were interested in selling their stock. Roth learned that Purple Cross' management was exceedingly capable and the Company's business was written profitably, but that the company was quite undercapitalized. The company provided a limited market for the inside shareholders desiring to sell, but the company was only paying $25 to $30 per share. Based upon his examination, Roth determined that Purple Cross shares could be acquired for less than their intrinsic value.

However, later in Roth's investigation, he learned that a re-insurance treaty, an agreement with American Guaranty Life Ins. Co. which permitted Purple Cross to underwrite more business than its own assets would otherwise permit, was in danger of being canceled by action of the Oregon Insurance Department. Purple Cross had negotiated a replacement

reinsurance treaty with TransAmerica, but the Oregon Insurance Commission refused to allow the replacement reinsurance treaty to be implemented. Purple Cross' financial problems were further complicated when the Federal Savings and Loan Insurance Corp. ("FSLIC") seized the assets of American Guaranty Financial Corp. (the owner of American Guaranty Life Ins. Co.) which in turn prompted the Oregon Insurance Department to seize American Guaranty Life Ins. Company. The net result of these events was that they posed a great threat to what had been an otherwise solvent Purple Cross.

In response to this situation, the Laurentian Capital Group injected some capital into American Guaranty Life Ins. Co. which permitted American Guaranty to make an orderly disposition of its excess holdings in order to comply with Oregon insurance law. After initiating the rehabilitation of American Guaranty, the Laurentian Capital Group

purchased all of the remaining outstanding stock of Purple Cross through one of Laurentian's subsidiaries, Loyal American. Roth had virtually no involvement with either the injection of capital to rehabilitate American Guaranty nor the purchase of Purple Cross by Laurentian Capital Group. Nevertheless, as a courtesy and an accommodation for Roth's initial efforts in investigating Purple Cross and bringing to light both the opportunities and problems presented by Purple Cross' financial situation, Laurentian paid Roth $100,000.

Thus, once again, it is clear that Roth was not effecting "private securities transactions" for the accounts of others. Roth was compensated for his services as a "finder" or "reinsurance intermediary" with respect to Purple Cross.

6. **United Ins. Co., Inc.; 7/86; $104,250.00**

In this transaction, United Ins. Co., Inc. ("UICI") sought to purchase controlling

interest in Associated Companies through a public tender offer. Paragraph 16 of the tender offer document (NASD Exhibit 10) indicates that UICI had "retained Charles Roth to provide brokerage services in connection with Shares acquired pursuant to the Stock Purchase Agreement." The tender offer document further disclosed that Roth would receive a fee of $179,250 in connection with such services. Clearly, in this transaction, Roth was acting as a registered representative associated with Marich. Marich was aware of the transaction because Roth had provided the tender offer document to Marich. Thus, Roth considered himself to have complied with his obligations to Marich by informing Marich of the transaction, including them in its processing, and planning for Marich to share in the commission. However, as discussed above, when Marich's clearing agent, OTRA, bollixed the tender offer of one of Roth's customers, Gordon Bakken, and when Roth became involved in

another dispute with Marich over reimbursement for office expenses, Roth retained the commission as an offset against the amounts he claimed was owed by Marich.

The Commission Decision

In its Decision of August 25, 1992, the Commission partially affirmed and partially reversed the NBCC Decision. The Commission reversed the NBCC findings with respect to one transaction which was completed before this Court's decision in Landreth Timber Co. v. Landreth, 471 U.S. 681 (1985) rejecting the "sale of business" doctrine. Prior to that decision, the law of the Tenth Circuit, where Roth resided, recognized the "sale of business" doctrine. Further, the Commission ruled that the maximum fine that could be imposed on Roth was $15,000 per violation. The Commission imposed the maximum fine on Roth, calculating seven violations for a total fine of $105,000. All other sanctions imposed by the NBCC were affirmed.

The Court of Appeals' Decision

On Appeal to the Court of Appeals for the District of Columbia Circuit, the Court of Appeals affirmed the Commission's Decision, largely without comment. The Court of Appeals found, however, that § 15(a)(1) of the Securities Exchange Act contained a significant ambiguity. On the face of the statute, Roth was exempt from registering as a broker-dealer because he was registered as a representative of a registered broker-dealer, R.B. Marich, Inc. Thus, on the face of the statute, Roth should not have been found to be in violation of § 15(a)(1) of the Exchange Act. But the Court of Appeals deferred to the Commission's interpretation of § 15(a)(1), reading into the statute conditions that are not expressly stated. Specifically, the Court deferred to the Commission's interpretation that only where the broker-dealer, in this case Marich, exercised customary supervision, could the registered representative rely upon the

exemption from the registration requirement stated in § 15(a)(1). Thus, the Commission and the Court of Appeals created the anomalous situation of requiring a servant to supervise his master to ensure that the master is adequately supervising the servant. According to the Commission's interpretation, if the master fails to exercise the customary degree of supervision, the servant automatically runs afoul of the registration requirements of § 15(a)(1).

ARGUMENT

Pursuant to Supreme Court Rule 10, a writ of certiorari is warranted in this case for the following reasons:

(a) The Court of Appeals for the District of Columbia Circuit has rendered a decision in conflict with decisions of other United States Courts of Appeal on the same matter; and

(b) The Court of Appeals for the District of Columbia Circuit has decided an important question of federal law which has not been, but

should be, settled by this Court, and which conflicts with decisions of this Court.

A. The Court Applied the Incorrect Standard For Interpreting Ambiguous Statutes That Are Penal In Nature.

In its March 16, 1994 Opinion, the Court of Appeals determined that § 15(a)(1) of the Securities Exchange Act of 1934, 15 U.S.C. § 78o(a)(1) (1988) is ambiguous. Slip. Op. (Appendix A) at 3, 4. The Court stated:

> The language of § 15(a)(1) does not make plain whether registered representatives like Roth are always exempt from registration as broker-dealers, or whether the exemption from broker-dealer registration extends only to those individuals subject to the supervisory relationship which normally accompanies association with a member firm.

Slip. Op. (Appendix A) at 4. The Court then applied the second step of the rule set forth in Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837, 842-44, 104 S.Ct. 2778, 2781-82, 81 L.Ed.2d 694 (1984) ("Chevron") and Nuclear Information Resource Serv. v. Nuclear Regulatory Comm'n, 969 F.2d

1169, 1173 (D.C. Cir. 1992) (en banc). Finding the Commission's construction of § 15(a)(1) to be reasonable and consistent with the statute's purpose, the Court of Appeals adopted the Commission's interpretation. However, in doing so, the Court of Appeals applied the incorrect legal standard.

The rule of construction set forth in Chevron provides that the Court must "defer to the agency's interpretation of the statute if it is reasonable and consistent with the statute's purpose." Id. However, that rule of construction does not apply where, as here, the statute being construed is penal in nature.

Other decisions of this Court, and the Chevron case itself, reveal that the rule stated in Chevron has always been limited to, and should be limited to, those cases where the statute under consideration was not a penal statute. Cf. Chevron, supra (challenge to EPA regulation allowing states to treat all pollution-emitting devices within same

industrial grouping as though they were encased within a single "bubble"); Nuclear Information, supra (where the statute being interpreted concerned "how the 'hearing' is to be held" and "whether the Commission must rehear issues already resolved at earlier stages in the licensing process"); Chemical Manufacturers Ass'n v. EPA, 919 F.2d 158, 162-63 (D.C. Cir. 1990) (review of regulations requiring closure of unretrofitted facilities); Northwest Airlines, Inc. v. FAA, 14 F.3d 64, 69 (D.C. Cir. 1994) (challenge to approval of $3 passenger facility charge to finance eligible airport-related projects); National Recycling Coalition, Inc. v. Browner, 984 F.2d 1243, 1250 (D.C. Cir. 1993) (challenge to EPA regulations governing procurement for federal government). None of these cases in which the Chevron rule was applied involved the interpretation of a penal statute.

The Court of Appeals was faced with this same issue in American Dental Ass'n v. Shalala,

3 F.3d 445, 447 (D.C. Cir. 1993). However, in that case, the Court of Appeals was not required to resolve the issue because the Court determined that it was not necessary to go beyond the first step of the Chevron test. Here, the Court of Appeals had already determined that it is necessary to go beyond the first step of the Chevron test, and so was required to go to the second step.

Because the violation of § 15(a)(1) subjects private parties to criminal sanctions, and because it has subjected Roth to civil sanctions in this case, it must be narrowly construed against the interpretation advocated by the Commission. Gates & Fox Co., Inc. v. Occupational Safety and Health Review Comm'n, 790 F.2d 154, 156 (D.C. Cir. 1986). See also Yellow Bus Lines, Inc. v. Drivers, Chauffeurs & Helpers Local Union 639, 913 F.2d 948, 955 (D.C. Cir. 1990). As stated by Judges Scalia, Silberman, and Wald:

> If a violation of a regulation subjects private parties to criminal

> or civil sanctions, a regulation cannot be construed to mean what an agency intended but did not adequately express.

Gates & Fox Co., Inc., supra.

> [L]aws must provide explicit standards for those who apply them. A vague law impermissibly delegates basic public policy matters to policemen, judges, and juries for resolution on an *ad hoc* and subjective basis, with the attendant dangers of arbitrary and discriminatory application.

Grayned v. Rockford, 408 U.S. 104, 108-09, 92 S.Ct. 2294, 2298-99, 93 L.Ed.2d 222 (1972). By applying the rule of statutory construction set forth in Chevron to a penal statute, the Court of Appeals impermissibly permitted the interpretation of a vague law to be delegated by Congress to the Commission.

Perhaps Judge Silberman phrased it best when, in Satellite Broadcasting Co., Inc. v. FCC, 824 F.2d 1, 3, (D.C. Cir. 1987) the Court stated:

> To be sure we normally defer to an agency's reasonable interpretation of its own rules. And we assume, arguendo, that the FCC's interpretation here is a reasonable

> one. But as counsel for the FCC conceded at oral argument - as we thought she must - if the Commission had interpreted its rules as did the petitioner we similarly would have been obligated to defer to that interpretation because it, at a minimum, is also reasonable. There is the rub. The Commission through its regulatory power cannot, in effect, punish a member of the regulated class for reasonably interpreting Commission rules. Otherwise the practice of administrative law would come to resemble "Russian Roulette". The agency's interpretation is entitled to deference, but if it wishes to use that interpretation to cut off a party's right, it must give full notice of its interpretation. We accordingly vacate as arbitrary and capricious the FCC's order dismissing these applications and remand this case for their reinstatement nunc pro tunc.

(Citation omitted.)

Further, because the Commission's interpretation creates the unreasonable requirement of mandating that the servant supervise the master to ensure that the master is properly supervising the servant, the Commission's interpretation is unreasonable and not entitled to deference under the Chevron test.

B. **The Court of Appeals' Interpretation Of § 15(a)(1) Of The Securities Exchange Act of 1934 Cannot Be Constitutionally Applied To Roth Under The Facts Of This Case.**

The essence of the Commission's position, and the Court of Appeal's Opinion, is that, despite the plain language of § 15(a)(1), a registered representative is not exempt from registering as a broker-dealer where he "was not subject to the supervisory relationship which normally accompanies association with a member firm." Slip Op. (Appendix A) at 4. However, to punish a registered representative where, as here, such lack of supervision was not caused by any effort by the representative to evade supervision, but rather by the member's own failure to supervise, violates all notions of fundamental fairness and due process. Due process will not countenance that a servant be punished for the defalcation of his master.

Here, there is no evidence in the record that Roth evaded the supervision of R.B.

Marich. Quite to the contrary, the record shows, that the transactions engaged in by Roth were precisely the sort of transactions that came within the ordinary scope of his employment with Marich. Cf. S.E.C. v. Ridenour, 913 F.2d 515 (8th Cir. 1990) (cited by the Court of Appeals) (representative surreptitiously conducted side business through secret nominee accounts).

To punish Roth for the failure of Marich to supervise him more closely creates an absurd application of § 15(a)(1), under the circumstances of this case. In effect, Roth is being sanctioned for failing to supervise Marich with respect to Marich's supervision of him.

C. The Court Of Appeals Erred By Upholding The Sanctions Imposed By The Securities And Exchange Commission In The Absence Of An Articulation Of Reasons By The Commission Justifying The Seriousness Of The Sanctions.

The Court of Appeals erred in failing to require the Commission to articulate reasons

justifying the seriousness of the sanctions imposed on Roth (including the most severe monetary sanctions the Commission could impose).

> It is the function of the courts to determine whether the Commission has, in a given case, exceeded the bounds of its remedial authority. In order for the court to discharge this duty in the matter before [it], it is necessary that the Commission articulate the reasons for the proposed sanction.

Beck v. S.E.C., 413 F.2d 832, 833-34 (6th Cir. 1969).

Here, the Commission failed to adequately articulate its reason for imposing the severe sanctions upon Roth of (a) the maximum allowable fine; (b) a six-month suspension from the NASD and; (c) the requirement that Roth requalify for membership by re-examination. The only justification given by the Commission for imposing these severe sanctions is that "Roth's unsupervised activities deprived those with whom he dealt of protections they had a right to expect and exposed his nominal

employer to unwarranted risks." S.E.C. Decision (Appendix B) at 10. However, the same can be said in every case where there is a violation of the private securities transaction rule. There is no articulation by the Commission as to why, in this case, these severe sanctions are justified. The Court of Appeals was not permitted to speculate as to reasons the Commission might have had for upholding the imposition of such severe sanctions. Beck v. S.E.C., 413 F.2d at 834.

As was done in the Beck case, this case should be remanded to the Commission to either articulate reasons justifying these severe sanctions or reduce the sanctions to a level justified by the reasons articulated in the Commission's decision of August 25, 1992. Id.

WHEREFORE, Petitioner Roth requests that this Court grant Certiorari on the Opinion of the Court of Appeals for the District of Columbia Circuit issued March 16, 1994.

Respectfully submitted this _____ day of August, 1994.

HOPPER AND KANOUFF, P.C.

By:_____

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CHARLES A. ROTH

APPENDIX OF OPINIONS, ORDERS, FINDINGS OF FACT, AND CONCLUSIONS OF LAW SOUGHT TO BE REVIEWED

A. Roth v. Securities and Exchange Commission, 22 F.3d 1108, 62 USLW 2624, Fed. Sec. L. Rep. (CCH) ¶ 98,206 (D.C. Cir. 1994).

B. In Re Charles A. Roth, 52 SEC Docket 1102, Exchange Act Rel. No. 34-31085, 1992 WL 2166933 (S.E.C. 1992).

C. Order dated June 2, 1994 denying Petition For Rehearing.

Notice: This opinion is subject to formal revision before publication in the Federal Reporter or U.S.App.D.C. Reports. Users are requested to notify the Clerk of any formal errors in order that corrections may be made before the bound volumes go to press.

United States Court of Appeals

FOR THE DISTRICT OF COLUMBIA CIRCUIT

Argued January 10, 1994 Decided March 16, 1994

No. 92-1557

CHARLES A. ROTH,
PETITIONER

v.

SECURITIES AND EXCHANGE COMMISSION,
RESPONDENT

Petition for Review of an Order of the
Securities and Exchange Commission

Gene R. Thornton argued the cause and filed the briefs for petitioner.

Lucinda O. McConathy, Assistant General Counsel, Securities and Exchange Commission, argued the cause for respondent. With her on the brief were *Paul Gonson*, Solicitor, Securities and Exchange Commission, *Jacob H. Stillman*, Associate General Counsel, Securities and Exchange Commis-

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Bills of costs must be filed within 14 days after entry of judgment. The court looks with disfavor upon motions to file bills of costs out of time.

sion, and *Susan K. Straus,* Attorney, Securities and Exchange Commission.

Before SILBERMAN, SENTELLE, and HENDERSON, *Circuit Judges.*

Opinion for the Court filed by *Circuit Judge* SENTELLE.

SENTELLE, *Circuit Judge:* Petitioner Charles Roth seeks review of an order of the Securities and Exchange Commission ("SEC" or "Commission"), partially affirming final disciplinary action by the National Association of Securities Dealers ("NASD"). For the reasons set forth below, we deny the petition for review in all respects.

In 1988 the NASD began disciplinary proceedings against Roth, who was a registered representative with R.B. Marich, Inc., a member firm of the NASD. The NASD charged Roth with violating Art. III, §§ 1 & 40 of the NASD Rules of Fair Practice, which prohibit any person associated with a NASD member firm from effecting a private securities transaction unless the member firm is given prior written notice. Roth was also charged with violating Art. III, § 1 of the NASD Rules of Fair Practice, by failing to register himself as a broker-dealer pursuant to § 15(a)(1) of the Securities Exchange Act of 1934, 15 U.S.C. 78o(a)(1) (1988). The violations were alleged to have arisen out of Roth's participation in various insurance company securities sales on seven separate occasions between 1985 and 1986.

The NASD Board of Governors found that Roth had violated the rules pertaining to private securities transactions and broker-dealer registration. Roth was fined $510,038.13, suspended from associating with a member firm for six months, and ordered to requalify by examination as a registered representative. Roth appealed the decision of the NASD to the SEC, pursuant to 15 U.S.C. §§ 78s(d)(2) & (e)(1) (1988). The SEC vacated the NASD's sanction for one of the transactions and reduced Roth's total fine to $105,000, but otherwise upheld the findings and conclusions of the NASD.

Before this court, Roth argues that the NASD's penalty provisions and "private securities transactions" rules are un-

constitutionally vague; that the SEC's interpretation of the private securities transactions rules and of § 15(a) of the Securities Exchange Act are erroneous; that substantial evidence does not support the SEC's factual conclusions that Roth effected private securities transactions and acted as a broker-dealer; and that his sentence is excessive. We find these challenges to be meritless, and affirm the SEC's order in all respects. Roth's arguments do not warrant separate discussion, with one exception: namely, that he was not required to register as a broker-dealer under § 15(a) since he was at all times a registered representative with R.B. Marich, Inc., a registered broker-dealer.

* * * * *

Section 15(a)(1) of the Securities Exchange Act, 15 U.S.C. § 78o(a)(1) (1988), provides in relevant part that

> It shall be unlawful for any broker or dealer which is . . . a natural person not associated with a broker or dealer . . . to effect any transactions in, or to induce or attempt to induce the purchase or sale of, any security . . . unless such broker or dealer is registered [with the Commission].

Roth claims that the plain language of § 15(a)(1) exempts him from any duty to register as a broker-dealer, since he was a "natural person . . . associated with a broker or dealer" when the six securities transactions in question took place. The SEC contends that § 15(a)(1)'s registration exemption for persons associated with a broker-dealer applies only if the person is acting within the "scope" of his or her association with the member firm. We evaluate Roth's statutory claim mindful of the fact that Congress delegated substantial authority to the Commission to set forth registration requirements for broker-dealers, and that an agency's interpretation of an ambiguous statute should be affirmed if reasonable and consistent with the statute's purpose. *See Nuclear Info. Resource Serv. v. Nuclear Regulatory Comm'n*, 969 F.2d 1169, 1173 (D.C. Cir. 1992) (en banc).

The broker-dealer registration requirement serves as the "keystone of the entire system of broker-dealer regulation."

Frank W. Leonesio, Exchange Act Release No. 23,524, 36 SEC Docket 457, 464 (Aug. 11, 1986). A broker-dealer that has registered with the Commission is bound to abide by numerous regulations designed to protect prospective purchasers of securities, including standards of professional conduct, financial responsibility requirements, recordkeeping requirements, and supervisory obligations over broker-dealer employees. *See generally* David A. Lipton, *A Primer on Broker–Dealer Registration,* 36 CATH. U. L. REV. 899 (1987). The interlocking requirements of registration and supervision act to ensure that "securities are [only] sold by a salesman who understands and appreciates both the nature of the securities he sells and his responsibilities to the investor to whom he sells." *Persons Deemed Not to Be Brokers,* Exchange Act Release No. 20,943 (May 9, 1984), 49 Fed. Reg. 20,512, 20,515 (1984).

The language of § 15(a)(1) does not make plain whether registered representatives like Roth are always exempt from registration as broker-dealers, or whether the exemption from broker-dealer registration extends only to those individuals subject to the supervisory relationship which normally accompanies association with a member firm. The SEC's resolution of this ambiguity is reasonable in light of the structure and evident purposes of the statutory scheme. Roth's contrary reading would leave the exemption with no reason to exist. Why would Congress exempt from registration those natural persons associated with a registered entity unless it reposed faith in the latter's supervision? If an individual is operating as a broker-dealer outside the course and scope of his employment, the employer's registration would seem to have little relevance.

The record clearly reflects that Roth conducted a private securities business completely separate from R.B. Marich's operations.[1] As Roth admitted in his submissions to the

[1] Illustratively, Roth corresponded with clients on stationery bearing only his name, billed clients in his own name, received payment in that fashion, kept separate records of customer transactions, and maintained offices separate from those of Marich.

NASD, this arrangement allowed him to solicit clients and consummate transactions "autonomously," with "negligible" supervision from R.B. Marich and "without the licensing authority of a broker dealer." Roth's clients were accordingly deprived of the numerous regulatory protections afforded to purchasers and sellers of securities, either directly through broker-dealer registration or indirectly through a supervisory relationship with a member firm. Other circuits have found violations of the broker-dealer registration requirement when a securities salesman has acted outside the scope of his association with a member firm. *See, e.g., Securities & Exchange Comm'n v. Ridenour*, 913 F.2d 515, 517 (8th Cir. 1990) (bond salesman violated § 15(a)(1) by engaging in a series of undisclosed, private securities transactions as part of private bond business of which member firm had no knowledge or opportunity to supervise).

Because the SEC's interpretation and application of § 15(a)(1) in this case were reasonable and Roth's remaining challenges are meritless, we deny Roth's petition for review.

It is so ordered.

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 31085 / August 25, 1992

Admin. Proc. File No. 3-7327

In the Matter of the Application of

CHARLES A. ROTH
3033 East First Avenue
Denver, Colorado

For Review of Disciplinary Action Taken by the

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

OPINION OF THE COMMISSION

REGISTERED SECURITIES ASSOCIATION -- REVIEW OF DISCIPLINARY PROCEEDINGS

Violations of Rules of Fair Practice

Failure to Inform Employer of Private Securities Transactions

Failure to Register as a Broker-Dealer

Where registered representative of member firm of registered securities association engaged in private securities transactions without prior written notification to member, and acted as broker without required registration, held, association's findings of violation substantially affirmed, fine reduced since it exceeded the maximum amount

specified in a notice by association, and sanctions otherwise sustained.

APPEARANCES:

Dennis A. Graham and Gene R. Thornton, of Hopper, Kanouff, Smith, Peryam and Terry, for Charles A. Roth.

T. Grant Callery, John J. Flood, and Shirley H. Weiss, for the National Association of Securities Dealers, Inc.

I.

Charles A. Roth, who was a registered representative of R.B. Marich, Inc., a member of the National Association of Securities Dealers ("NASD"), appeals from disciplinary action taken against him by the NASD. The NASD found that, from March 1985 until the fall of 1986, Roth participated in seven private securities transactions without giving Marich prior written notification,[1] and acted as a broker without being registered as such. It censured Roth, fined him $510,038.13, suspended him from association with any member for six months, and required him to requalify as a registered representative by examination. Our findings are based on an independent review of the record.

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[1] Roth seeks to introduce additional evidence concerning, among other things, further details of those transactions. However, he has not shown, as required by Rule 19d-3(e) under the Securities Exchange Act, that there were reasonable grounds for failing to adduce that evidence before the NASD. Accordingly, his request is denied.

II.

Roth specialized in insurance company securities. He had his own office separate from that of Marich and corresponded with clients on stationary that carried only his own name. He billed clients in his own name and received their direct payments. Roth assisted insurance companies in locating and acquiring outstanding shares of their own stock or those of other insurance companies. He also helped such companies locate potential purchasers of their business.

A. The NASD's rules prohibit any person associated with a member firm from participating in any manner in a private securities transaction outside the regular course or scope of his employment without giving prior written notice to the member.[2] Roth admits that he did not give notice with respect to six of the seven transactions at issue[3] but claims that no notice was required because they were not securities transactions but the sales of businesses.[4]

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[2] Article III, Section 40 of the NASD's Rules of Fair Practice. Prior to November 12, 1985, this prohibition was embodied in an interpretation of the NASD's Board of Governors.

[3] As discussed below, Roth contends that Marich had notice of his participation in the seventh transaction.

[4] We reject Roth's claim that these transactions constituted "reinsurance" rather than securities transactions. Reinsurance, which is the transfer by one insurance company to another of all or part of its risk

The following is a summary of the six transactions.

1) Western Surety Life Insurance Company

Roth was asked by an attorney for Western's parent company to locate someone to purchase Western. After successfully locating a purchaser and introducing him to the management of Western's parent, Roth received $73,666.61 from the attorney.

2) Classified Financial Corporation

Roth was requested by Classified's majority shareholder to locate other shareholders and encourage them to sell their minority interests. Roth persuaded one shareholder to sell its shares, and received a fee of $5,180.50 for doing so.

3) North American National Corporation

Roth was requested by a client to assemble a block of North American stock. The client then sold the block to another insurance company which paid Roth $75,000 as an "accommodation." The client paid Roth $12,078.68 ($.0625 per share) to cover his expenses.

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on existing policies, is normally accomplished through the purchase of policies, not the acquisition of stock in another corporation. Even if the spreading of risk was incidental to some of these transactions, securities were transferred, not insurance policies.

4) Yorktown Insurance Company

Roth assisted a "reinsurance intermediary" in arranging for the sale of all of Yorktown's outstanding stock, which was owned by a long-time friend. Roth shared the fee with the intermediary, receiving $73,862.34.

5) International Bank of Washington, D.C. / Life Investors, Inc.

Southmark Corporation retained Roth to assist it in acquiring the shares of International. Roth secured an option for Southmark from Life Investors, which owned 30% - 40% of the shares, subject to the approval of various state commissions. Prior to such approval, a subsidiary of International purchased the shares from Life Investors. Roth requested a fee from Life Investors for triggering the acquisition of its International stock at a price above the market. Life Investors agreed to pay Roth $66,000 to cover what he claimed were some of his expenses.

6) Loyal American Insurance Company / Purple Cross Insurance Company

Loyal American's parent corporation asked Roth to investigate Purple Cross and determine the advisability of acquiring its stock. Roth learned that there were only 57,787 Purple Cross shares outstanding, that its shares were not traded on NASDAQ or quoted by the National Quotation Bureau, Inc., that a number of shareholders were attempting to sell, and that the company itself provided only a limited market, offering only $25 to $35 per share. Roth was given a list of potential sellers and, using Marich as a market maker, began offering $40 per share. He ultimately purchased 800 shares of Purple Cross for Loyal

American at prices ranging from $40 to $50 per share. These transactions were processed through Marich.

During his investigation, Roth discovered that American Guaranty Life Insurance Company, with which Purple Cross had a reinsurance contract, was experiencing financial difficulties, thereby placing Purple Cross in jeopardy. Roth suggested to Loyal American's parent that it either purchase up to 20% of Purple Cross or lend it $5 to $10 million to enable it to take over American Guaranty. The parent corporation rejected Roth's suggestions. Instead, it infused capital directly into American Guaranty, and had Loyal American purchase all of the remaining outstanding stock of Purple Cross for over $160 per share. While Roth claims to have had "virtually no involvement" in either transaction, Loyal American's parent paid Roth $100,000 as a "courtesy" and an "accommodation" for his effort, time and expense.

As noted above, Roth claims that these transactions were not securities transactions but sales of businesses. Under the so-called "sale of business" doctrine adopted by certain courts prior to May 1985, the acquisition of the controlling interest in a business was not deemed to be a securities transaction under the federal securities laws. Although that doctrine was subsequently rejected by the Supreme Court,[5] Roth argues that the Court's decision is not controlling since it did not specifically address reporting obligations for private securities transactions. We find no merit in the distinction Roth seeks to draw.

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[5] Landreth Timber Company v. Landreth, 471 U.S. 681 (1985); Gould v. Ruefenacht, 471 U.S. 701 (1985).

The Court clearly intended its ruling to have a broad application, covering the situation at issue.[6]

Roth further points out that, before the Supreme Court's decision was issued in May 1985, the Tenth Circuit, where these transactions occurred, had adopted the "sale of business doctrine."[7] He asserts that he had begun working on the six transactions prior to the Supreme Court's decision, and had already completed the Western transaction before it was issued. He therefore contends that these transactions were not subject to the NASD's notice requirement.

It does not appear that all of the transactions at issue involved the sale of a business. In any event, as Roth concedes, only the Western transaction had been completed before the Supreme Court issued its decision rejecting the sale of business doctrine. In view of the law in the Tenth Circuit prior to the Court's action, Roth

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[6] See, e.g., Landreth Timber Company v. Landreth, supra, 471 U.S. at 687; Gould v. Ruefenacht, supra, 471 U.S. at 704-706. In Terry Don Wamsganz, 48 S.E.C. 257, 258-259 (1985), we applied Landreth to reporting requirements for private securities transactions.

[7] Chandler v. Kew, Inc., 691 F.2d 443 (1977); Christy v. Cambron, 710 F.2d 669 (1983). In Wamsganz, supra, the circuit where the transaction in question occurred had not yet ruled with respect to that doctrine. We therefore concluded that Wamsganz had "assumed the risk that the issue might be decided against him."

could have reasonably concluded that no notice was required in connection with the Western transaction, and we shall therefore set aside the NASD's finding of violation with respect thereto. However, when the Supreme Court acted, Roth still engaged in the remaining transactions. Accordingly, the Court's action triggered his duty to disclose those transactions to his employer, an obligation he did not fulfill.

Roth further claims that his role in these transactions was not that of a broker or registered representative, but a "finder," "business broker," or "intermediary" between insurance companies. He asserts that he did not believe or realize that the NASD's rule applied to him. However, that rule requires that notice be given of participation "in any manner" in a private securities transaction.[8] All of the transactions at issue involved a transfer of securities that was assisted by Roth and for which he was compensated. We have previously held that a registered representative who merely introduces clients seeking to purchase control of a company to company management, and later receives a finder's fee when the transaction is consummated, participates in a securities transaction to an extent sufficient to subject him to the NASD's notice requirement.[9] We find Roth's degree of involvement in these

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[8] The interpretation in force before the adoption of the rule prohibited an associated person from being "involved in any way" in a private securities transaction without giving prior written notice to his employer.

[9] Terry Don Wamsganz, supra.

transactions at least as great as the respondent's in that case.[10]

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[10] Roth also argues that the NASD's rule is impermissibly vague. This argument lacks merit. The justification for a claim of vagueness is the principle that fair notice must be given of conduct or activities that are proscribed or covered by a particular enactment. Smith v. Goguen, 415 U.S. 566, 572 (1974); Association of American Physicians and Surgeons v. Weinberger, 395 F. Supp. 125, 138 (N.D. Ill. 1975) aff'd, 423 U.S. 975 (1975). In the regulatory context, the courts, in reviewing a claim that a statute or regulation is vague, use a standard of review that is less strict than that applied to criminal statutes, See Village of Hoffman v. The Flipside, Hoffman Estates, Inc., 455 U.S. 489, 498-499 (1982), or statutes where First Amendment rights are involved. See Smith v. Goguen, supra, 415 U.S. at 573; Big Mama Rag, Inc. v. United States, 631 F.2d 1030, 1035 (D.C. Cir. 1980). Thus, "[a] statute or regulation is unconstitutionally vague only if its meaning is so ambiguous or unclear that 'men of common intelligence must necessarily guess at its meaning.'" Broadrick v. Oklahoma, 413 U.S. 601, 607 (1973) (quoting Connally v. General Construction Co., 269 U.S. 385, 391 (1926)). Although what is at issue here is a private organization's regulations rather than a statute, the distinction is irrelevant for purposes of this analysis. We believe that the NASD

Roth notes that the notice requirement only applies to transactions outside the regular course or scope of an associated person's employment with a member. He argues that "these were exactly the sort of transactions [that he] was ordinarily involved in while he was associated with Marich." However, the fact that Roth was "ordinarily involved" in such transactions while associated with Marich does not mean that he was exempt from the notice requirement. Unless the transactions in question were effected through, or with proper notice to, Marich, Roth's argument simply means that he was violating the NASD's notice requirement on a regular basis.

B. As noted above, Roth argues that he fulfilled the NASD's notice requirement with respect to the seventh transaction at issue. That transaction evolved after Roth advised United Insurance Companies, Inc. that it might be able to purchase a controlling interest in Associated Companies, Inc. from Associated's president, its principal shareholder. With Roth's assistance, United subsequently negotiated the purchase of a 9.9% interest in Associated from its president. Immediately thereafter, United decided to make a tender offer for additional Associated shares. In its tender offer circular, United disclosed the stock purchase from Associated's president and the fact that Roth was being paid a fee of

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rule at issue in this case gives fair guidance to firms, their associated persons, and NASD decisionmakers with respect to the type of activities that are subject to its restrictions. See Todd and Company, Inc. v. SEC, 557 F.2d 1008, 1013 (3d Cir. 1977); Zester Herbert Hatfield, 48 S.E.C. 958, 960 (1988).

$179,250 for his "brokerage services" in connection with that transaction.[11]

Although Roth never informed Marich about United's stock purchase, he asserts that Marich was given proper notice of that transaction in the tender offer circular. However, Roth is not aided by the fact that Marich received an offering circular. The NASD's rule requires that an employer be given prior written notice of private securities transactions. The tender offer document clearly shows that, when it was printed, United's purchase from Associated's president had already been completed. Thus Marich was not given the notice required by the NASD's rule.[12]

In light of the foregoing, we affirm the NASD's findings of violation, except with respect to the Western transaction. That finding is hereby set aside.

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[11] Roth considered that this fee was payment for bringing the parties together and "lining up" the takeover. . It appears from the language of the circular that United understood the fee to be payment for Roth's efforts in connection with its acquisition of a controlling interest in Associated from its president.

[12] The United transaction occurred in 1986, after the Supreme Court had issued its decision in Landreth.

III.

The NASD found that Roth improperly engaged in the business of effecting securities transactions without being registered as a broker-dealer. As noted above, Roth did not limit his activities to executing securities transactions as an associated person of Marich but acted as a broker in transactions form which Marich was excluded. The NASD's findings are based on this latter aspect of Roth's activities.

Section 15(a)(1) of the Securities Exchange Act requires the registration of any broker who is a natural person not associated with a broker-dealer and who effects transactions in, or induces or attempts to induce the purchase or sale of, any security.[13] Roth argues that, since he was associated with a broker-dealer, he was not required to register. We do not agree.

Section 15(a)(1) was designed to ensure that customers would in all instances receive either the regulatory protections that result from a salesman being registered himself or the protections that stem from the salesman being supervised by a registered firm. Here Roth's registration with Marich did not provide the protections envisioned by Congress. On the contrary, Roth engaged in extensive securities activities that were concealed from his employer and went far beyond the scope of his association with that firm. In those circumstances, Roth was

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[13] A broker is defined in Section 3(a)(4) of the Act as "any person engaged in the business of effecting transactions in securities for the account of others . . ."

required to obtain independent registration as a broker-dealer.

Roth admits that he was largely unsupervised, acted independently, and used Marich only to "clear" his business or make markets. As noted above, he had his own office separate from that of Marich, and corresponded with clients on stationary bearing only his own name, without indicating any association with another firm. He billed his clients in his own name, and received direct payment for his efforts. Thus the tender offer document circulated in the United transaction characterized Roth as an "independent securities broker" and stated that he (not Marich) was providing "brokerage services."

It is clear that, despite his nominal registration with Marich, Roth operated as an independent broker. Accordingly, he was required to register as such in his own name, a step he failed to take. We therefore affirm the NASD's findings of violation except to the extent that they are based on the Western transaction.[14]

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[14] Our conclusion does not conflict with our finding that Roth was associated with Marich for the purpose of requiring him to report his private securities transactions. Roth's only license to engage in the securities business was his NASD registration as a representative of Marich. By virtue of that association, Marich was entitled to be notified if Roth intended to participate in any securities transaction not involving Marich. As the record shows, however, Roth operated as an independent broker without giving

IV.

Roth argues that the $510,038.13 fine assessed against him by the NASD is impermissibly high. Under the circumstances presented here, we agree.

A. At a time that Roth committed the violations at issue, the NASD's Rules of Fair Practice specified that the maximum fine that could be imposed for any one violation was $15,000.[15] Indeed, the form that the NASD provided Roth for answering its complaint advised him of this limitation. However, the limitation had been removed by the time the Board of Governors issued its decision. Roth now claims that the NASD's imposition of a higher fine than was permitted at the time he engaged in the violative conduct at issue violates the ex post facto and due process provisions of the Constitution.

Marich notice of his activities. Thus he violated both the provisions governing notice of private securities transactions and the requirement that an independent broker register as such. See Frank W. Leonesio, 48 S.E.C. 544 (1986); Eugene T. Ichinose, Jr., 47 S.E.C. 393 (1980); Leonard L. Gooch, 47 S.E.C. 276 (1980).

[15] Roth argues that the maximum fine was $15,000 per person. However, that is a misreading of the NASD's rule.

The ex post facto provisions do not apply to civil sanctions, such as those at issue here, but only to criminal penalties.[16] Moreover, while administrative regulation normally has only prospective effect, absent clear intent to the contrary,[17] an increased sanction may be applied retroactively without running afoul of the Constitution where the misconduct at issue was a violation at the time of its commission.[18]

In the instant case, however, as noted above, the form that the NASD provided Roth for answering its complaint stated that the maximum fine that could be imposed was $15,000 per violation. Roth claims that he relied on that notice to his detriment by not retaining counsel below, concluding that it would not be cost-effective. Under the circumstances, we consider that fairness calls for a reduction in the fine to $15,000 per violation, as

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16 Karpa v. Commissioner of Internal Revenue, 909 F.2d 784 (4th Cir. 1990); Korte v. Office of Personnel Management, 797 F.2d 967, 972 (Fed. Cir. 1986).

17 Bowen v. Georgetown University Hospital, 488 U.S. 204 (1988).

18 Chase Securities Corp. v. Donaldson, 325 U.S. 304 (1945); Jefferson Disposal Co. v. Parish of Jefferson, La., 603 F. Supp. 1125 (E.D. La. 1985). See also Licari v. Commissioner of Internal Revenue, 946 F.2d 690 (9th Cir. 1991); First Philadelphia Corporation, 45 S.E.C. 73, 74 n.3 (1972).

specified in the notice.[19] We have previously held that, for purposes of calculating the maximum fine the NASD can impose, each breach of a single duty constitutes a separate violation. We have sustained six violations stemming from Roth's failure to give notice of private securities transactions and a separate violation arising from his independent participation in the securities business without broker-dealer registration.[20] Thus the maximum fine that we consider proper is $105,000.[21]

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19 Section 15A(b)(8) of the Securities Exchange Act requires fairness in NASD disciplinary proceedings.

20 See Sirianni v. SEC, 677 F.2d 1284, 1289 (9th Cir. 1982), and the cases there cited. Our authority to treat each transaction as a separate registration violation likewise is clear. However, because the NASD, in its original complaint and decision, contemplated notice requirements as separate violations but the registration requirement as a single violation, in this instance we will conform our analysis to theirs.

21 The NASD argues that the amount of the fine does not exceed its authority because, in effect, it is a disgorgement of "ill-gotten gains"; that the NASD has the authority to order disgorgement; and that there is and was no limitation on the amount of disgorgement it can order. While it is true that the NASD can order a respondent to make disgorgement, it did not do so here. Having chosen to designate the amount at issue a fine, the NASD cannot change that

B. We are unable to conclude that the fine as reduced, and the other sanctions assessed by the NASD, are excessive or oppressive. Roth's unsupervised activities deprived those with whom he dealt of protections they had a right to expect and exposed his nominal employer to unwarranted risks. Moreover, the reduced fine is substantially less than the fees Roth earned from his violative conduct. Even though we have not sustained all of the NASD's findings of violation, we see no warrant for any further reduction in the sanctions imposed by the NASD.

An appropriate order will issue.[22]

By the Commission (Chairman BREEDEN and Commissioners SCHAPIRO, ROBERTS, and BEESE).

/s/ Jonathan G. Katz
Secretary

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designation when its order is challenged on appeal.

[22] All of the parties' contentions have been considered. Their arguments are rejected or sustained to the extent that they are inconsistent or in accord with the views expressed in this opinion.

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 31085 / August 24, 1992

Admin. Proc. File No. 3-7327

In the Matter of the Application of

CHARLES A. ROTH
3033 East First Avenue
Denver, Colorado

For Review of Disciplinary Action Taken by the

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

ORDER MODIFYING DISCIPLINARY ACTION TAKEN BY REGISTERED SECURITIES ASSOCIATION

On the basis of the Commission's opinion issued this day, it is

ORDERED that the sanctions imposed by the National Association of Securities Dealers, Inc. ("NASD") on Charles A. Roth be, and they hereby are, reduced to censure, a six-month suspension from association with any NASD member, a $105,000 fine, and the requirement that Roth requalify as a registered representative by examination.

By the Commission.

/s/ Jonathan G. Katz
Secretary

UNITED STATES COURT OF APPEALS

FOR THE DISTRICT OF COLUMBIA CIRCUIT

NO. 92-1557 **SEPTEMBER TERM, 1993**

Charles A. Roth,

Petitioner,

v.

Securities and Exchange Commission,

Respondents

BEFORE: Silberman, Sentelle and
Henderson, Circuit Judges

O R D E R

The Clerk is directed to file petitioner's petition for rehearing and upon consideration thereof, it is

ORDERED, by the Court, that the petition is denied.

Per Curiam
FOR THE COURT:
RON GARVIN, CLERK

BY:
/s/ Robert A. Bonner
Deputy Clerk

FOR ARGUMENT

No. 93-404

Supreme Court, U.S.
FILED
OCT 11 1994
OFFICE OF THE CLERK

In The

Supreme Court of the United States

October Term, 1994

ARTHUR L. GUSTAFSON, DANIEL R. McLEAN
and FRANCIS I. BUTLER,

Petitioners,

v.

ALLOYD CO., INC. and
WIND POINT PARTNERS II, L.P.,

Respondents.

On Writ Of Certiorari
To The United States Court Of Appeals
For The Seventh Circuit

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SUPPLEMENTAL QUESTION PRESENTED

Does section 12(2) of the Securities Act of 1933 apply to secondary transactions as well as initial offerings of securities?

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SUMMARY OF ARGUMENT

Section 12(2) does not expressly limit its civil remedy to "initial offerings" of securities, which are commonly understood to be sales by issuers. The term "prospectus," as used in section 12(2), is defined broadly and is not limited to statements made in connection with initial offerings. The other key provisions of the Act, sections 5, 11, 12(1) and 17, all apply, in varying degrees, to secondary offerings. The legislative history contains no unambiguous evidence of a legislative intent to restrict the civil remedy provided by section 12(2) to initial offerings. Moreover, one of the principal remedial purposes of the Act would be thwarted by excluding secondary sales from the scope of section 12(2), and there is no strong countervailing policy reason for construing the section narrowly. Finally, even if section 12(2) were construed as applying to less than the full array of secondary transactions, it should apply to sales by controlling shareholders of the issuer, such as the sale by petitioners in this case.

ARGUMENT

I. The Language And Structure Of The Statute Demonstrate That Section 12(2) Applies To Both Initial And Secondary Sales Of Securities.

The 1933 Act neither defines nor employs the terms "initial" offering or "secondary" sale. As reflected in the *amicus* briefs of the Solicitor General and the Securities Industry Association ("SIA"), however, these terms have well-settled meanings. An "initial offering" is generally understood to be a sale of securities by the issuer, while a "secondary" sale is a subsequent transaction by any other person or entity.[1] (*See* SEC Br. 5-6 n.5; SIA Br. 2 n.2) The

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[1] *Black's Law Dictionary* contains similar definitions of the two categories of offerings. "Securities offerings are generally of two types: primary (proceeds going to the company for some lawful purpose) and secondary (where the funds go to a person other than the company; *i.e.*, selling stockholders)." *Black's Law Dictionary* 1082 (6th ed. 1990).

absence of these or any similar terms from the Act indicates that Congress did not intend to draw any distinction between initial and secondary securities transactions. As discussed below, neither the text nor the structure of the Act supports limiting section 12(2) to the narrow category of initial offerings.

A. The Text Of The Statute Does Not Limit Section 12(2) To Initial Offerings.

The text of section 12(2) squarely contradicts the argument that the civil remedy applies only to initial offerings of securities – that is, offerings *by issuers*. Congress defined the term "issuer" in the 1933 Act, *see* 15 U.S.C. § 77b(4), and used the term repeatedly throughout the Act in specifying the obligations, exemptions and remedies under the Act. *See, e.g., id.* §§ 77c(a)(1), 77d(1), 77d(6), 77k(b). Section 12(2), however, contains no language limiting its application to sales by "issuers." To the contrary, section 12(2) provides a civil remedy against "*[a]ny person*" who offers or sells a security through a misleading prospectus or oral statement. *Id.* § 771 (emphasis added).

The breadth of section 12(2) is confirmed by section 2(3), which defines "sale" and "sell" broadly to include "*every* contract of sale or disposition of a security." *Id.* § 77b(3) (emphasis added). And this Court held in *Gould v. Ruefenacht*, 471 U.S. 701 (1985), that the "securities" covered by section 12(2) include those sold in a privately-negotiated resale of a corporation's stock. Thus, the operative transactional terms in section 12(2) encompass both initial and secondary sales of securities.

The leading decision limiting section 12(2) to initial offerings, *Ballay v. Legg Mason Wood Walker, Inc.*, 925 F.2d 682 (3d Cir.), *cert. denied*, 112 S. Ct. 79 (1991), ignores these broad, all-inclusive terms. The court in *Ballay* instead focused exclusively on the phrase "by means of a prospectus

or oral communication," which it read as limiting section 12(2) to "the sale of a security in an initial distribution." *Id.* at 688. The court concluded that "the plain meaning of the words 'prospectus or oral communication' together is that buyers may recover for material misrepresentations made in a prospectus or in an oral communication related to a prospectus or initial offering." *Id.* The court did not explain how the "plain meaning" of the various terms used by Congress in the definition of "prospectus" supports limiting section 12(2) to initial offerings.[2]

The terms used in defining "prospectus" include any "notice, circular, advertisement, letter, or communication" offering a security for sale. 15 U.S.C. § 77b(10). Neither these terms nor the term "oral communication" connotes a limitation to offerings by issuers, as opposed to sales by other owners of securities. As the court noted in *Pacific Dunlop Holdings, Inc. v. Allen & Co.*, 993 F.2d 578, 582, 588 (7th Cir. 1993), section 2(10) defines prospectus "very broadly," and the key determinant of a prospectus is "whether the substance of the words used offers to sell or confirm[s] the sale of a security."

Nor does the use of the term "prospectus" in section 10 of the Act, 15 U.S.C. § 77j, support limiting section 12(2) to initial offerings, as asserted by the court in *Ballay*. 925 F.2d at 688-89. Section 10 sets forth the information required in a particular kind of prospectus – one issued in conjunction with a registration statement. The SEC has long recognized the distinction between a "formal prospectus" meeting the criteria of section 10 and the broader category of prospectus defined in section 2(10). SEC Release No. 33-2623, 11 Fed. Reg.

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[2] The Eleventh Circuit's decision in *First Union Discount Brokerage Services, Inc. v. Milos*, 997 F.2d 835 (11th Cir. 1993), adds nothing to the analysis of this issue. First, the court in *First Union* did no independent analysis of the initial/secondary issue, but rather adopted the *Ballay* court's analysis. Second, the case did not involve any secondary sale to Milos "by means of a prospectus or oral communication" containing misrepresentations about any securities. Rather, the case involved a liquidation of Milos's margin account by his discount broker, and the section 12(2) claim was therefore apparently not based on any purchase of securities by him. *Id.* at 840.

10964 (July 25, 1941); *see* Resp. Br. 23 n.17; SEC Br. 10-11. Nothing in the text of section 12(2), or elsewhere in the Act, indicates Congress intended to limit "prospectus" as used in section 12(2) to the "formal" section 10 prospectus.[3]

In sum, the text of section 12(2) simply cannot be read as limiting its civil remedy to sales by issuers or sales of newly issued shares. The only word in section 12(2) relied upon by advocates for limiting the section to initial offerings – "prospectus" – cannot support such a limitation because Congress defined the term using words that are not limited to the context of initial offerings. (*See* Resp. Br. 20-24) To read section 12(2) as limited to initial offerings would require ignoring the words Congress used, as well as those it elected not to use, in drafting the provision.

B. The Structure Of The 1933 Act Confirms That Section 12(2) Is Not Limited To Initial Offerings.

The other provisions of the 1933 Act confirm that section 12(2) is not limited to initial offerings. Contrary to the opinion in *Ballay*, 925 F.2d at 691, the registration requirement of section 5 and the remedial provisions of sections 11 and 12(1) all apply to secondary transactions as well as initial offerings.

Section 5 provides that, "[u]nless a registration statement is in effect as to a security, it shall be unlawful for any person" to sell such security "through the use or medium of any prospectus or otherwise." 15 U.S.C. § 77e(a)(1). While section 4(1) of the Act exempts from registration "transactions by any person other than an issuer, underwriter, or dealer," a broad range of secondary sales remain subject to the registration requirement. For example, if a shareholder of a corporation decides to sell his shares through an underwriter, registration is required under section 5 because sales by

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[3] In *Pacific Dunlop*, the Seventh Circuit also thoroughly analyzed whether the "context" of the Act requires a different definition of prospectus in section 12(2) than that contained in section 2(10). 993 F.2d at 584-88. After examining the structure and text of the Act, the court concluded that nothing in the statutory context requires a definition of prospectus in section 12(2) "contrary to the broad definition of section 2(10)." 993 F.2d at 588.

an underwriter are not exempted under section 4. *See, e.g.*, C. Johnson, *Corporate Finance and the Securities Laws* 10 (1990). Similarly, a "control person" who sells "restricted securities," except under the narrow circumstances prescribed in SEC Rule 144, will be deemed to be engaged in a "distribution" and thus required to register his or her shares.[4] *Id.* at 14; *see* 3 L. Loss & J. Seligman, *Securities Regulation* 1507 (3d ed. 1989).

Section 12(1) provides a civil remedy against "[a]ny person" who "offers or sells a security in violation of section 77e." 15 U.S.C. § 77l(1). Thus, any secondary offering that must be registered under section 5, if consummated without a registration statement, will subject the seller to the civil remedy in section 12(1).

Section 11, which provides civil remedies for material misrepresentations or omissions in any registration statement, similarly extends beyond initial offerings. A purchaser of securities has a remedy under section 11 for misrepresentations in a registration statement for a secondary offering of restricted securities by a control person or a secondary distribution through an underwriter. Moreover, section 11 contains no privity requirement; it creates a right of action for any person who acquires securities covered by a false or misleading registration statement. 15 U.S.C. § 77k(a). Section 11 therefore provides a civil remedy not only for those persons who purchased directly on the offering, but also for those who subsequently purchase in the after-market and can trace the particular shares they purchase to the registration statement. *See, e.g., Klein v. Computer Devices, Inc.*, 591 F. Supp. 270, 273 n.7 (S.D.N.Y. 1984); 9 L. Loss & J. Seligman, *Securities Regulation* 4267 (3d ed. 1992).

Thus, both *Ballay* and *amicus* SIA are wrong in asserting that section 12(2) must be limited to initial offerings in order to be consistent with sections 11 and 12(1). Even if section 12(2) were read in the narrowest possible way as co-extensive

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[4] As defined in Rule 144, "restricted securities" include those acquired directly or indirectly from an issuer or its affiliates in any transaction not involving a public offering. 17 C.F.R. § 230.144(3).

with sections 11 and 12(1), it still would apply to numerous secondary transactions.

Furthermore, as explained more fully in Buyers' principal brief, section 12(2) is *not* limited to those transactions covered by sections 11 and 12(1). For example, section 3 exempts various types of securities from the registration requirements of the Act, but section 12(2) expressly states that sales of such securities are not exempt from the civil remedies for misrepresentation. Similarly, section 4 exempts certain transactions from the registration requirement, but the exemption is limited by its terms to section 5. *See* 9 L. Loss & J. Seligman, *Securities Regulation* 4198 (3d ed. 1992) (section 12(2) "applies to all sales of securities, whether or not registered and whether or not the particular security or transaction is exempted from § 5").

Finally, it is well settled that the criminal anti-fraud provision in section 17 of the Act is not limited to initial offerings. As this Court stated in *United States v. Naftalin*, 441 U.S. 768, 777-78 (1979), section 17 "was intended to cover any fraudulent scheme in an offer or sale of securities, whether in the course of an initial distribution or in the course of ordinary market trading." Since section 12(2) similarly addresses misrepresentations in connection with sales of securities, it should also be applied to secondary sales.

II. The Legislative History Of The 1933 Act Does Not Support Construing Section 12(2) As Limited To Initial Offerings.

The language of a statute is presumed to express the intent of Congress. *See Ardestani v. INS*, 112 S. Ct. 515, 520 (1991). Where, as here, the scope of a statute can be determined by analyzing its language and structure, only the clearest legislative history would justify reaching a different result. *See, e.g., National Organization for Women, Inc. v. Scheidler*, 114 S. Ct. 798, 806 (1994). No such clear legislative intent exists in this case.

This Court has previously observed that the legislative history of section 12(2) is "sparse," *Randall v. Loftsgaarden*,

478 U.S. 647, 657 (1986), and even an ardent advocate for construing section 12(2) narrowly has acknowledged that the provision "was never separately analyzed and was only occasionally mentioned in the legislative history." Prentice, *Section 12(2): A Remedy for Wrongs in the Secondary Market?*, 55 Albany L. Rev. 97, 107 (1991). Nothing in the House Report (H.R. Rep. No. 85), the Senate Report (S. Rep. No. 875), or the Conference Report (H.R. Conf. Rep. No. 152) states that section 12(2) is limited to initial offerings. Nor is there any statement in the legislative history that Congress intended the word "prospectus" to limit section 12(2) to initial offerings. At bottom, the legislative history is simply silent on this point.[5]

Unable to cite anything in the legislative history specifically supporting a constricted reading of section 12(2), both Sellers and SIA rely on general statements by Members of Congress, as well as snippets from the House Report, indicating that the primary focus of the Act was initial offerings. (*See, e.g.*, Pet. Br. 23 n.8, 34-36; SIA Br. 14-16) While Buyers concede that statements in the House Report, as well as comments by several members of Congress, suggest the principal focus of the Act was initial offerings, that view was not universal. There was certainly no consensus for the proposition that the Act excludes secondary sales from the civil remedies for misrepresentation. Some Members of Congress, as well as leading commentators, expressed the contemporaneous view that the 1933 Act covers both initial and secondary offerings.

During debates on the Securities Exchange Act in May 1934, for example, Senator Kean provided a detailed

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[5] Of course, one cannot infer from this silence that Congress intended to exclude secondary transactions from the scope of section 12(2). *See Landreth Timber Co. v. Landreth*, 471 U.S. 681, 696 n.7 (1985). As the Court explained in *Landreth*, the courts and the SEC have applied the 1933 and 1934 Acts to a variety of transactions as to which the legislative history is silent. *Id.*

comparison of the 1933 Act with the British Companies Act of 1929.[6] 78 Cong. Rec. 8666, 8674-8696 (May 12, 1934). That comparison explained that "[t]he United States act covers original *and subsequent transactions* in securities; the British act deals chiefly with the original offer of securities to the public and not to subsequent transactions in those securities." *Id.* at 8674 (emphasis added); *see also id.* at 8676 ("United States act applies (disregarding the exceptions) to all transactions in all securities"). Similarly, during the House debates on an early version of the Exchange Act (H.R. 9323), Congressman Mapes explained that the 1933 Act "was based upon the theory that *anyone* who made a false representation to an innocent investor should reimburse the innocent investor whatever he suffered because of that false representation." 78 Cong. Rec. 8105 (emphasis added).

The individuals principally involved in drafting the 1933 Act also expressed the contemporaneous view that section 12(2) applies to secondary transactions. For example, Arthur Dean, who consulted with the House Commerce Committee during the drafting process, and then-professor Felix Frankfurter, the head of the team that drafted the Act, both wrote in 1933 that section 12(2) applies to secondary transactions. *See* Dean, *The Federal Securities Act: I*, 8 Fortune 50, 102 (1933); Frankfurter, *The Federal Securities Act: II*, 8 Fortune 53, 108 (1933). As explained in Buyers' principal brief, that view was echoed even by early critics of the Act. (*See* Resp. Br. 46-47) And with few exceptions, leading commentators, including Professor Loss, have consistently said that section 12(2) is not limited to initial distributions. (*Id.* at 47 n.36)

In sum, nothing in legislative history of section 12(2) expressly reflects a legislative intent to limit the civil remedy in that section to initial offerings. Collectively, comments by individual Members of Congress regarding the scope of the

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[6] This Court has noted previously that the British Companies Act was the "statutory antecedent" of the federal securities laws. *SEC v. Ralston Purina Co.*, 346 U.S. 119, 123 (1953).

Act are, at best, ambiguous. Accordingly, the legislative history does not justify departing from the plain language of the statute.

III. Limiting Section 12(2) To Initial Offerings Is Inconsistent With The Remedial Purpose Of The Act And Is Not Required By Any Compelling Policy Concerns.

Application of section 12(2) to secondary sales of securities furthers the purposes of the Act by addressing one of the principal goals Congress sought to achieve. In holding that the term "seller" should be construed broadly for purposes of section 12(1), this Court explained in *Pinter* that such a construction "furthers the purposes of the Securities Act – to promote full *and fair* disclosure of information to the public in the sales of securities." *Pinter v. Dahl*, 486 U.S. 622, 646 (1988) (emphasis added). The Court did not suggest that this remedial purpose was limited to initial offerings. To the contrary, misrepresentations can occur just as readily – and are just as invidious – in secondary sales of securities. There is no sound basis in the policy underlying the Act to construe section 12(2) as limited to initial offerings.[7]

A number of examples illustrates this point. If a controlling shareholder of a corporation decided that the corporation should issue new shares of stock and sold them in a registered offering, this "initial offering" would clearly come within section 12(2). If the same shareholder decided instead to resell a portion of his holdings, and did so through an underwriter in a public offering, this "secondary sale" would not be covered by section 12(2) under a construction limited to initial offerings. Similarly, if this controlling shareholder sold his shares in a private placement, the buyers would have no

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[7] This policy analysis informed the early decisions holding that section 12(2) applies to both initial and secondary offerings. *See, e.g., Wilko v Swan*, 127 F. Supp. 55, 59 (S.D.N.Y. 1955) (noting that limiting section 12(2) to initial distributions "would frustrate the remedial purposes of the statute and lead to absurd and wholly incongruous results").

claim under section 12(2) even if the sale occurred by means of an offering circular that was identical, word-for-word, to the prospectus used in connection with an initial offering by the corporation. This result cannot be squared with the remedial purpose of the statute. There is no sound reason for giving buyers a remedy for misrepresentations contained in the written materials used by the issuer to sell stock, but not for the same misrepresentations made by the corporation's controlling shareholders in a secondary sale.

SIA urges that section 12(2) must be limited to initial offerings by issuers because broader application would have a devastating impact on dissemination of research reports prepared by securities analysts. (SIA Br. 18-24) The concerns raised by SIA are ill-founded and do not justify a reading of section 12(2) at odds with the text and structure of the Act. SIA's argument rests on a faulty premise – that the construction of section 12(2) adopted by the Seventh Circuit in *Pacific Dunlop* will result in open-ended liability for firms that prepare research reports on publicly-traded securities. There are at least two formidable statutory barriers to a potential suit based on an analyst's research report, both of which belie the calamitous result predicted by the SIA.

First, SIA misreads *Pacific Dunlop* as holding that a "prospectus" for purposes of section 12(2) includes "*any* document connected with the sale of a security." (SIA Br. 8, emphasis added) As *Pacific Dunlop* recognized, section 2(10) defines "prospectus" as a communication that "offers any security for sale or confirms the sale of any security." 15 U.S.C. § 77b(10). Research reports generally do not offer securities for sale.[8] Thus, a research report, even if riddled with factual errors, would not give rise to a claim under

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[8] Analysts' reports invariably contain a legend stating that the report "is not an offer to buy or sell or a solicitation of an offer to buy or sell" the securities. The SEC has also addressed this issue under its rule-making power. Rule 139 prescribes the circumstances in which a research report on securities of an issuer will not be deemed an "offer to sell" the securities, and thus will not constitute a "prospectus" under section 2(10), even though the firm issuing the report is involved in a distribution of such securities. 17 C.F.R. § 230.139.

section 12(2) because it does not come within the definition of "prospectus."

Second, a plaintiff seeking to assert a claim against the firm that publishes a research report would have to establish that the firm is a "seller" subject to section 12(2). This Court has never addressed the scope of a statutory seller for purposes of section 12(2), although in *Pinter* it did construe the term as used in section 12(1). 486 U.S. at 641-54. In *Pinter*, the Court held that a statutory seller is one who either passes title to the securities or "successfully solicits the purchase, motivated at least in part by a desire to serve his own financial interests or those of the securities owner." *Id.* at 647.

Assuming that this same definition applies to section 12(2), the publisher of a research report could be liable only if it was found to have "successfully solicited" the sale of the securities at issue. A growing body of case law supports the proposition that a "soliciting seller" must have some direct or personal contact with the purchaser. *See* Fisher, *Parsing* Pinter *Four Years Later: Defining a Statutory Seller Under Section 12 of the Securities Act*, 21 Sec. Reg. L.J. 46, 58 & n.41 (1993) (citing cases). It is not at all clear that a firm publishing a research report could be liable under section 12(2) unless it also used that report in personally and actively soliciting a customer to purchase the securities covered by the report.[9]

Finally, construing section 12(2) to apply only to some, but not all, secondary transactions necessarily involves writing into the statute a limitation that is not there. This kind of legislative line-drawing, which entails careful balancing of

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[9] SIA also argues that securities analysts would be required "to investigate every conceivable fact regarding a company" if they are subject to section 12(2) liability. (SIA Br. 23) This is again an overblown concern since section 12(2) does not impose liability for pure omissions. Section 12(2) creates liability only for affirmative misstatements by a seller or for omission of facts that make the seller's statements misleading. There is no sound policy reason why a broker who negligently makes a misstatement of fact to a purchaser of securities should escape liability simply because the transaction was a secondary sale rather than an initial offering.

the various interests to be served by the statute, is uniquely the function of Congress.

IV. The Transaction In This Case Had The Characteristics Of An Offering By The Issuer.

To decide this case, the Court need not decide the extent to which section 12(2) applies to all the participants involved in typical sales of securities on organized securities exchanges. Nor must the Court decide whether, and under what circumstances, section 12(2) applies to analysts' research reports and similar materials published by those engaged in the securities business. These issues are not presented by the facts of this case and their resolution is not essential to the decision here.

The only "initial/secondary" issue presented by this case is whether a sale of a corporation's securities through oral and written representations made by those in control of the corporation is a transaction covered by section 12(2). Even the legislative history frequently cited in support of a narrow reading of section 12(2) confirms that Congress intended the Act to apply to secondary transactions having the basic attributes of an "initial offering." The House Report on an earlier version of the Act explained that, as then drafted, the bill "does not affect the ordinary redistribution of securities *unless such redistribution takes on the characteristics of a new offering by reason of the control of the issuer possessed by those responsible for the offering*." H.R. Rep. No. 85, 73d Cong., 1st Sess. 5 (1933) (emphasis added).

The sale of Sellers' stock in this case had the key characteristics of an "initial offering." The Alloyd board of directors passed a resolution directing that "*the Company* actively solicit bids for the purchase of all of the outstanding stock of the Company." (R. 56, Dep. Ex. 3 at 1; emphasis added) An investment banker was retained "on behalf of the Company and its shareholders" to solicit offers. (*Id.*) That firm prepared and circulated to potential purchasers a "Profile" that was designed to, and did, generate offers for Sellers' stock. (R.

56, Dep. Exs. 2 and 5; McLean Dep. 132; Gustafson Dep. 72-73)

Sellers owned 100% of the stock of Alloyd, held the three most senior management positions in the company, and comprised a majority of the board of directors. All of the key financial information provided to Buyers came from Sellers or their agents. In these circumstances, Sellers were for all practical purposes indistinguishable from the issuer of the stock of Alloyd. Accordingly, section 12(2) should apply to *this* transaction even if the Court concludes that the section does not apply to all secondary market transactions.[10]

The reasoning of the Third Circuit in *Ballay* supports this result. The *Ballay* court concluded there was "good reason" to provide a rescissionary remedy in connection with initial offerings because "sellers receive the full purchase price from the investors and are the investors' sole source of information concerning the value of the security." 925 F.2d at 693. The court contrasted this situation with "sellers in the aftermarket, such as [brokers], who receive only a commission and who are not the investors' sole source of information concerning the value of the stock." *Id.* Here, unlike the transaction in *Ballay*, the proceeds of the sale went to Sellers, and Sellers were Buyers' primary source of information concerning Alloyd.

Similarly, the *Ballay* court reasoned that the rescissionary remedy under section 12(2) was appropriate in the context of initial offerings because misrepresentations in such offerings "can influence the purchase price of securities." *Id.* Under these circumstances, the court explained, "rescissionary damages are appropriate to make an investor whole and deter any negligence on the part of a seller of batch offerings." *Id.* The court found such a remedy inappropriate where misrepresentation by a broker in the secondary market "is less

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[10] The district court, ignoring these undisputed facts, found that Buyers had failed to provide evidence that the transaction in this case "possesses the characteristics of a new offering." (J.A. 20-21) In reaching this conclusion, the court erroneously relied on the irrelevant fact that Alloyd was formed some 30 years before Sellers' disposition of their shares. (J.A. 21)

likely to affect the price of a security and so should not be so heavily penalized." *Id.* Here, once again, the transaction falls within the category for which *Ballay* found application of section 12(2) warranted because the information provided by Sellers was the key determinant of the price paid by Buyers for the Alloyd stock. (*See, e.g.*, R. 56, Kracum Dep. 55-56)[11]

CONCLUSION

For the reasons stated above, section 12(2) is not limited to initial offerings of securities, and the judgment of the court of appeals should be affirmed.

Respectfully submitted,

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[11] Respondent Wind Point calculated the purchase price based on a multiple of 7.5 times Alloyd's earnings before interest and taxes. (R. 56, Kracum Dep. 112, 115-16) This earnings figure, in turn, was based directly on the interim financial information provided by Sellers, which is the basis for Buyers' misrepresentation claim.

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FILED
NOV 9 1994
CLERK

No. 94-404

In the Supreme Court of the United States

OCTOBER TERM, 1994

CHARLES A. ROTH, PETITIONER

v.

SECURITIES AND EXCHANGE COMMISSION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION IN OPPOSITION

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QUESTION PRESENTED

Whether Section 15(a)(1) of the Securities Exchange Act of 1934, 15 U.S.C. 78*o*(a)(1), requires a person employed by a registered securities broker to register himself as a securities broker when he provides brokerage services independent of his employer.

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BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. A1-A5)[1] is reported at 22 F.3d 1108. The opinion of the Securities and Exchange Commission, Securities Exchange Act Release No. 31085 (August 25, 1992) (Pet. App. B1-B17), is unreported, but appears at 52 S.E.C. Docket 1314.

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[1] The appendix to the Petition includes the court of appeals' opinion, with pages numbered 1-5, and the Commission's opinion and order, with pages numbered 1-18. To facilitate reference to the appendix, references to the court of appeals' opinion will be in the form "Pet. App. A__" and references to the Commission's opinion and order will be in the form "Pet. App. B__".

JURISDICTION

The judgment of the court of appeals was entered on March 16, 1994. A petition for rehearing was denied on June 2, 1994. Pet. App. C1. The petition for a writ of certiorari was filed on July 14, 1994. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

Petitioner, a securities broker, worked both on his own and as an employee of a broker-dealer firm, R.B. Marich, Inc. (Marich). The firm was registered with the Securities and Exchange Commission (Commission) as a broker-dealer and was a member of the National Association of Securities Dealers, Inc. (NASD). Petitioner was not, however, independently registered as a broker with the Commission. The NASD disciplined petitioner for engaging in securities transactions without being registered as a broker, in violation of Section 15(a)(1) of the Securities Exchange Act of 1934 (Exchange Act), 15 U.S.C. 78*o*(a)(1), and without giving Marich prior written notice of the transactions, in violation of Article III, Section 1 of the NASD Rules of Fair Practice and Article III, Section 40 of those Rules as amended. Pet. App. A2, B3 & n.2. The Commission sustained the disciplinary action, Pet. App. B1-B18, and the court of appeals affirmed, Pet. App. A1-A5.

1. The NASD is a national securities association registered with the Commission under Section 15A of the Exchange Act, 15 U.S.C. 78*o*-3 (1988 & Supp. V 1993). It thus is responsible for regulating its member firms and persons associated with its members, subject to comprehensive oversight by the Commission. See 15 U.S.C. 78*o*-3, 78s. To that end, the NASD is authorized to impose disciplinary sanctions on its member firms and

persons associated with such firms. *Ibid.* Disciplinary action taken by the NASD is subject to review by the Commission. 15 U.S.C. 78s(d)(2) and (e)(1). On review, the Commission considers the record *de novo* and makes its own factual findings and legal conclusions. 15 U.S.C. 78s(e)(1). The Commission's decisions are subject to judicial review. See 15 U.S.C. 78y(a).

2. This case involves petitioner's participation in seven securities transactions in 1985 and 1986. Pet. App. B3-B6. Petitioner conducted those transactions as part of a securities business he ran outside the scope of his employment with Marich. In that business, he specialized in insurance securities, including assisting insurance companies in locating and purchasing shares of their own outstanding stock, and purchasing stock in other insurance companies. *Id.* at B3. Petitioner maintained his independent business at an office separate from Marich, employed his own secretary, used his own business stationery that did not indicate any association with Marich, billed clients and received payment in his own name, and kept records apart from the firm's. *Id.* at A4-A5 & n.1, B3, B13. He did not give the firm prior written notice of the seven transactions. *Id.* at B2. He worked on those transactions "autonomously," with "negligible" supervision, and "without the licensing authority of a broker dealer." *Id.* at A5.

3. a. The NASD brought charges against petitioner for violation of the broker-dealer registration requirements of the Exchange Act and for violation of the NASD Rules requiring a person associated with a member firm to give written notice to the firm before engaging in any private securities transactions outside the scope of his association with it. Section 15(a)(1) of

the Exchange Act, 15 U.S.C. 78o(a)(1), makes it unlawful for

> any broker or dealer which is * * * a natural person not associated with a broker or dealer * * * to effect any transactions in, or to induce or attempt to induce the purchase or sale of, any [non-exempt] security * * * unless such broker or dealer is registered [with the Commission].

Section 3(a)(4) of the Act, 15 U.S.C. 78c(a)(4), defines the term "broker" as "any person engaged in the business of effecting transactions in securities for the account of others." Article III, Section 1 of the NASD Rules provides:

> A member, in the conduct of his business, shall observe high standards of commercial honor and just and equitable principles of trade.

NASD Manual ¶ 2151, at 2014 (1991). When the first three of the seven transactions charged occurred, the Board of Governors' Interpretation of Article III, Sections 1, 27 and 28 provided, in pertinent part:

> Depending upon all the facts and circumstances, private securities transactions effected outside the usual or normal course or scope of employment and nowhere reflected on broker/dealer books and records may expose the participants to charges of serious violations of federal securities laws, as well as industry rules and regulations, and to civil liability. In some instances, severe sanctions have been imposed on registered and associated personnel for engaging in private securities transactions effected outside the scope of their association and nowhere reflected on broker/dealer books and records.

> Persons associated with a member should also be aware that their involvement in private securities transactions outside the scope of their association as a member may raise serious questions regarding their need to register as broker/dealers and/or investment advisers under state and federal securities laws. * * *
>
> * * * * *
>
> It shall be deemed conduct inconsistent with just and equitable principles of trade for any person associated with a member to engage in a private securities transaction outside the regular course or scope of his association or employment with a member, for himself, or with or for any other person without prior written notification to the member.

NASD Manual ¶ 2177, at 2109-2 to 2109-3 (1985). Following an amendment effective November 12, 1985, Article III, Section 40 of the NASD Rules provided, in pertinent part:

> (a) *Applicability*—No person associated with a member shall participate in any manner in a private securities transaction except in accordance with the requirements of this section.
>
> (b) *Written notice*—Prior to participating in any private securities transaction, an associated person shall provide written notice to the member with which he is associated describing in detail the proposed transaction and the person's proposed role therein and stating whether he has received or may

receive selling compensation in connection with the transaction * * *.

(c) *Transactions for Compensation* —

(1) In the case of a transaction in which an associated person has received or may receive selling compensation, a member which has received notice * * * shall advise the associated person in writing stating whether the member: (A) approves the person's participation in the proposed transaction; or (B) disapproves the person's participation in the proposed transaction.

(2) If the member approves a person's participation in a transaction pursuant to Subsection(c)(1), the transaction shall be recorded on the books and records of the member and the member shall supervise the person's participation in the transaction as if the transaction were executed on behalf of the member.

(3) If the member disapproves a person's participation pursuant to Subsection (c)(1), the person shall not participate in the transaction in any manner, directly or indirectly.

* * * * *

(e) *Definitions*—For purposes of this section, the following terms shall have the stated meanings:

(1) "Private securities transaction" shall mean any securities transaction outside the regular

> course or scope of an associated person's employment with a member[.]

NASD Manual ¶ 2200, at 2186-2187 (1991).

An NASD hearing panel found that petitioner committed each of the violations charged. SEC R. 155-161. It censured him, fined him $20,000, and suspended him for twenty days from association with any NASD member. *Id.* at 161. On review, following a supplemental evidentiary hearing, the NASD Board of Governors affirmed the panel decision as to the violations. *Id.* at 400-405. It modified the sanctions by (1) extending to six months the period of petitioner's suspension, (2) imposing a requirement that petitioner re-qualify by examination before he could again become an associated person of an NASD member firm, and (3) imposing a fine of $510,038, based on the amount of compensation that petitioner received in connection with the transactions forming the basis of the charges against him. *Id.* at 405; Pet. App B2.

b. Petitioner applied to the Commission for review of the NASD's decision. Based on an independent review of the record, the Commission affirmed in part. Pet. App. B1-B18. It held that petitioner had violated the NASD Rules in six of the seven transactions charged by failing to give Marich prior written notice.[2] Petitioner's failure

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[2] Petitioner contended that the transactions were sales of businesses and therefore, under the "sale of business" doctrine, not deemed to be securities transactions. Because this Court did not reject the sale of business doctrine until 1985, see *Landreth Timber Co.* v. *Landreth*, 471 U.S. 681 (1985), after one of the seven transactions had been completed, the Commission set aside the NASD's finding of a violation with respect to that transaction. Pet. App. B6-B8.

to register as required by Section 15(a)(1) constituted a seventh violation. The Commission reasoned that the transactions were not effectuated through Marich so as to exempt petitioner from the prior written notice requirement, Pet. App. B10; rather, petitioner "operated as an independent broker," *id.* at B13. With respect to the Section 15(a)(1) violation, the Commission explained:

> Section 15(a)(1) was designed to ensure that customers would in all instances receive either the regulatory protections that result from a salesman being registered himself or the protections that stem from the salesman being supervised by a registered firm. Here, [petitioner's] registration with Marich did not provide the protections envisioned by Congress. On the contrary, [petitioner] engaged in extensive securities activities that were concealed from his employer and went far beyond the scope of his association with that firm. In those circumstances, [petitioner] was required to obtain independent registration as a broker-dealer.

Pet. App. B12-B13.

The Commission sustained the censure, the six-month suspension, and the re-examination requirement. Pet. App. B18. It reduced the fine, however, because the NASD had given notice to petitioner at the time he was charged that the maximum fine per violation was $15,000. *Id.* at B14-B16. The Commission calculated the maximum appropriate fine to be $105,000, based on six notice violations and one registration violation. *Id.* at B16. Imposition of such a fine was appropriate, the Commission concluded, because, among other reasons, it was "substantially less than the fees [petitioner] earned from his violative conduct." *Id.* at B17.

c. The court of appeals affirmed. Pet. App. A1-A5. The court rejected petitioner's contention that his association with the Marich firm relieved him of responsibility to register. The court noted:

> The language of § 15(a)(1) does not make plain whether registered representatives like [petitioner] are always exempt from registration as broker-dealers, or whether the exemption from broker-dealer registration extends only to those individuals subject to the supervisory relationship which normally accompanies association with a member firm.

Id. at A4. The court reasoned, however, that the purpose of the registration requirement—to ensure that unregistered brokers come within the supervisory ambit of a registered broker-dealer—would not be served by allowing the mere fact of association with a broker-dealer to legitimize transactions made wholly independent of the registered entity. *Ibid.* The employer's registration binds it "to abide by numerous regulations designed to protect prospective purchasers of securities, including standards of professional conduct, financial responsibility requirements, recordkeeping requirements, and supervisory obligations over broker-dealer employees." *Ibid.* The court explained that "[i]f an individual is operating as a broker-dealer outside the scope of his employment, the employer's registration would seem to have little relevance." *Ibid.* Adhering to the Commission's and the Eighth Circuit's interpretation of Section 15(a)(1), the court thus held that petitioner's participation in securities transactions outside the scope of his employment with Marich, without registering, violated the Act. Pet. App. A5,

citing *SEC* v. *Ridenour*, 913 F.2d 515, 517 (8th Cir. 1990).[3]

ARGUMENT

The decision of the court of appeals is correct and does not conflict with any decision of this Court or any other court of appeals. Further review is therefore unwarranted.

1. Petitioner contends (Pet. 31-36) that the court of appeals' interpretation of Section 15(a)(1) should be rejected because, in petitioner's view, the court impermissibly gave deference under *Chevron U.S.A. Inc.* v. *Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984), to the Commission's interpretation of a statute that petitioner characterizes as penal. No deference to the Commission is required, however, because the interpretation of Section 15(a)(1) adopted by the court of appeals is the only reasonable reading of the statute. See, *e.g.*, *SEC* v. *Ridenour*, 913 F.2d 515, 517 (8th Cir. 1990) (holding, without reliance on *Chevron*, that Section 15(a)(1) does not permit a person associated with a registered firm independently to conduct a securities business without separately registering). Section 15(a)(1) requires that all brokers either be registered themselves or associate with a registered broker. The purpose of the registration requirement is to ensure that every person acting as a broker is subject to regulatory oversight, which in turn protects the public and the securities market. Thus, even without the aid of

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[3] The court of appeals also summarily rejected petitioner's contentions that the NASD's private transactions rules and penalty provisions are unconstitutionally vague, that the Commission's decision was not supported by substantial evidence, and that the sanction was excessive. Pet. App. A2-A3.

the Commission's interpretation, the meaning of Section 15(a)(1) is evident.

As this case illustrates, petitioner's interpretation would undermine Section 15(a)(1) by permitting a person to rely on the registration of a firm with which he associates to legitimize his conduct of a wholly separate securities business bearing no relationship to that association and unbeknownst to the registered firm. Registration provides the link through which the Commission ensures that brokers comply with statutory and regulatory investor protection requirements. Petitioner's reading of the statute would break that link to associated persons acting on their own, thereby creating a major loophole in the Commission's system of broker-dealer regulation. That loophole cannot be squared with congressional intent to ensure comprehensive regulation through the registration requirement.

Although petitioner was subject only to civil sanctions in this case, he suggests (Pet. 34) that the availability of criminal sanctions for willful violations of the Act, see 15 U.S.C. 78ff(a), requires that Section 15(a)(1) be strictly construed. Rules of strict construction of criminal statutes do not apply when the statute is interpreted, as here, in a non-criminal context. See *SEC* v. *C.M. Joiner Leasing Corp.*, 320 U.S. 344, 353-355 (1943) ("[t]he weight of authority is committed to a liberal construction" of securities laws containing both civil and criminal penalties when they are applied in civil cases).[4]

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[4] The additional element of willfulness that must be proved to support a criminal violation of the Exchange Act distinguishes it from the National Firearms Act, which this Court strictly construed in *United States* v. *Thompson/Center Arms Co.*, 112 S. Ct. 2102, 2109-2110 (1992) (plurality opinion). In *Thompson/Center*,

Even if strict construction were appropriate, however, it would not require a different result. "[T]here is no canon against using common sense in reading a criminal law, so that strained and technical constructions do not defeat its purpose by creating exceptions from or loopholes in it." *Kordel* v. *United States*, 335 U.S. 345, 349 (1948). The requirement that penal statutes be strictly construed "is satisfied if the words are given their fair meaning in accord with the manifest intent of the lawmakers." *United States* v. *Brown*, 333 U.S. 18, 26 (1948). See also *United States* v. *R.L.C.*, 112 S. Ct. 1329, 1338 (1992) (plurality opinion) ("[W]e have always reserved lenity for those situations in which a reasonable doubt persists about a statute's intended scope even *after* resort to 'the language and structure, legislative history, and motivating policies' of the statute."), quoting *Moskal* v. *United States*, 498 U.S. 103, 108 (1990). This is especially true of Section 15(a)(1), the scope of which is unmistakable in light of the detailed (and unchallenged) NASD Rules prohibiting a person associated with a registered broker from providing brokerage services wholly independently of his firm. See pp. 5-6, *supra*.

Deference to the Commission's interpretation is, in any event, wholly appropriate. See *SEC* v. *Chenery Corp.*, 332 U.S. 194, 207 (1947) ("Our duty is at an end when it becomes evident that the Commission's action is based upon substantial evidence and is consistent with the authority granted by Congress."). Although the Exchange Act includes criminal penalties, it is

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the "rule of lenity" was held to be appropriate in the civil context because "the NFA has criminal applications that carry no additional requirement of willfulness." *Id.* at 2109 (plurality opinion).

fundamentally regulatory, not penal. See *Kennedy* v. *Mendoza-Martinez*, 372 U.S. 144, 168-169 (1963) (enumerating factors relevant to determining whether a statute is penal or regulatory). The Exchange Act provides for close regulation of the securities industry. It includes requirements as to the proper conduct of brokerage businesses and provides for Commission oversight and administration of a broad range of investor protection requirements. Violations need not be intentional to subject the violator to remedial sanctions such as those imposed on petitioner in this case. In sum, the Commission "has been entrusted by Congress with the interpretation, administration, and enforcement of the Securities Acts," and in the absence of "a conflict between those interpretations and the Congressional mandate," deference is due. *City Capital Associates Ltd. Partnership* v. *Interco Inc.*, 860 F.2d 60, 64 (3d Cir. 1988).

Petitioner has not identified any cases declining to defer to the Commission's reasonable interpretation of the Exchange Act, nor has he cited any cases interpreting Section 15(a)(1) not to require associated persons to register separately when they act as independent brokers. The bulk of cases he cites involved other agencies, and gave deference under *Chevron*. See Pet. 32-33 (citing cases). The cases in which *Chevron* deference was inappropriate involved circumstances clearly distinguishable from this case.[5]

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[5] In *Satellite Broadcasting Co.* v. *FCC*, 824 F.2d 1 (D.C. Cir. 1987), the court did not defer to the Federal Communications Commission's application of its own rule requiring certain applications to be filed in Gettysburg, Pennsylvania, rather than in the District of Columbia, because the FCC failed to give clear notice where applications were to be filed. Similarly, in *Gates & Fox Co.* v. *OSHRC*, 790 F.2d 154 (D.C. Cir. 1986), the court did

2. Petitioner's other arguments also lack merit. Petitioner contends (Pet. 36-38) that the Commission's interpretation of Section 15(a)(1) is unreasonable and violates his due process rights because it holds him responsible for his employer's failure to supervise him. There is, however, no due process impediment to holding employees rather than their employers responsible for employee conduct outside the scope of employment. The statute placed such responsibility on petitioner. He was sanctioned for his own defalcation, not that of his firm.

Petitioner also contends (Pet. 38-40) that the Commission failed to articulate reasons supporting its decision. In fact, the Commission explained that petitioner was subject to sanctions because his conduct "deprived those with whom he dealt of protections they had a right to expect and exposed his nominal employer to unwarranted risks." Pet. App. B17. It noted that petitioner's violations were extensive, *id.* at B10, B12, and that he concealed them from his firm, *id.* at B12. The Commission also explained that the amount of the monetary sanction was reasonable because it fell far short of the amounts petitioner earned from the violations. *Id.* at B17. Those statements more than sufficed to explain the basis for the sanctions imposed.

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not defer to the Department of Labor's interpretation of an Occupational Safety and Health Act regulation that gave constitutionally inadequate notice that the employer could be sanctioned for failing to provide rescue equipment to certain employees. Here, in contrast, in light of the unmistakable purpose of Section 15(a)(1) and the guidance provided by the related NASD Rules, there is no question that petitioner was on notice that he should have registered with the Commission.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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NOVEMBER 1994